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Legal protections accorded to minority shareholders in Kenya in corporate entities.

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Legal Protections Accorded to Minority Shareholders in Kenya in Corporate Entities

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DECLARATION

Student's Declaration:

I declare that this work has not been previously submitted and approved for the award of a degree by this or any other University. To the best of my knowledge and belief, the thesis contains no material previously published or written by another person except where due reference is made in the thesis itself.

ALFAYO ONGERI WYCLIFFE

13th November, 2021

ABSTRACT

The House of Lords had good intentions when it decreed in 1897 that a company had in law a fictitious separate personality distinct from its subscribers and promoters. With this decree the court in effect established an iron curtain in the name of a corporate veil between the company and the people in the backstage_ the real minds behind the company. Ever since there have been a myriad of instances when the iron curtain has been lifted to hold responsible those that have attempted to benefit fraudulently from behind the shield that is the separate legal personality of the company and its corporate veil.

The study gives a historical background on the legal framework that existed prior to the enactment of the Companies Act No. 17 of 2015. The study considers the high threshold required of minority shareholders whenever they seek a remedy for infringement of their interests. Arising from that background the study considers the extent to which the principles of separate legal personality and corporate veil hamper the utilization of the legal avenues for the protection of the interests of minority shareholders.

The study considers the fiction and contractarian theories of corporate governance. It considers the proposition of their proponents and the criticisms advanced against them. In the end, the study considers the justification for departure from the theories in order to make a case for corporate law to be invoked to protect the interests of minority shareholders. The study analyses the provisions of the Companies Act, Capital Markets Act and subsidiary regulations that enshrine avenues meant to protect the interests of minority shareholders. The study points out the lacunas that are still persistent.

In the penultimate the study analyzes a case study in order to contextualize the hindrances of the principles of separate legal personality and corporate veil in the pursuit for the protection of the interests of minority shareholders. Ultimately, the study makes recommendations that are meant to improve the corporate environment in which the minority shareholders can invest their resources.

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LIST OF ABBREVIATIONS / ACRONYMS

AGM Annual General Meeting

CMA Capital Markets Authority

eKLR electronic Kenya Law Reporting

LTD Limited

NSE Nairobi Securities Exchange

UK United Kingdom of Great Britain & Northern Ireland

USA United States of America

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Trollip JA Samuel and Others v President Brand Gold Mining Company [1969] (3) SA 629 (A).

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DEDICATION

To:

My dear beloved mother_ Ms. Zipporah Kemunto Oruru; you have always believed in me, invested resources and prayers and encouraged me on this academic journey. I really love you mum and may God bless you abundantly. I hope the completion of this phase of learning affords you yet another opportunity to be truly happy and sway to your favorite tunes.

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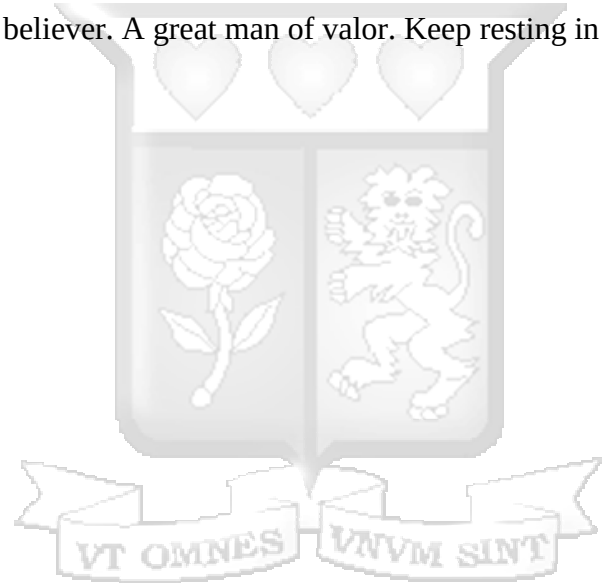

CHAPTER ONE: INTRODUCTION

"Governments charter corporations—and bestow upon them the remarkable gifts of perpetual life and limited liability—not primarily to make money for shareholders, but rather to promote the economy and opportunity for society at large. The essential obligation of corporate directors has thus historically been to the corporation itself: to nurture long-term economic growth that reaps benefits for, and avoids costly externalities on, the broader society. A corporation that succeeds in that effort will advance the interests of all its stakeholders, not just its shareholders. Conceived in this way, shareholder profit is not the sole objective of the corporation, but rather the byproduct of a well-functioning corporate governance regime[1]"

1.1 Background

Commercial investments have rapidly increased in the world. Companies have become the most efficient corporate vehicles to use in commercial investments.[2] According to the World Economic Forum's 2015-2016 Global Competitiveness Index, Kenya was ranked as one of the most convenient and attractive economies in sub-Saharan Africa in terms of investments.[3] Consequently, Kenya embarked on a stride aimed at maintaining or even improving this momentum and spur further economic growth. Part of the parameters adopted were the adoption of a competitive legal framework whose aim was to attract investors and at the same time protect their interests.[4] According to the Ease of Doing Business 2020 report, regulation that fosters the freedom of doing business is key to improvement of world economies.[5] This regulation must be one that prevents mistreatments of workers through proper labor laws and protection of one's investment particularly the minority shareholders.[6]

The *Doing Business* report measures 12 areas of business regulation in order to gauge the performance of world economies. The parameters are protecting minority investors, starting a

[1] Martin L and William S, Wachtell Lipton Memo: *Stakeholder Governance, Issues and Answers*, Oct. 25, 2019 on https://corpgov.law.harvard.edu/2019/10/25/stakeholder-governance-issues-and-answers/. Accessed 18 February 2021.
[2] World Bank's Doing Business Survey 2018.
[3] See https://www.weforum.org/reports/the-global-competitiveness-report-2016-2017-1 accessed 12 July 2021.
[4] The Kenyan parliament enacted the Companies Act No. 17 of 2015, repealing CAP 486 that had been in use since independence. At the same time the Business Registration Services Act No. 15 of 2015 aw the adoption of a technology-based platform that guarantees cost-effectiveness and timely transactions of company related services.
[5] Doing Business 2020: Comparing Business Regulation in 190 Economies, 2.
[6] Doing Business 2020: Comparing Business Regulation in 190 Economies, 2.

business, dealing with construction permits, getting electricity, registering property, getting credit, paying taxes, trading across borders, enforcing contracts, resolving insolvency, employing workers and contracting with the government. Of particular concern to this study is the protection accorded to minority investors where the study considers minority shareholders' interests in corporate governance.[7] Currently the number of economies that are considered in the *Doing Business* survey stands at 190.

Gauging through the above parameters, tremendous growth and improvements in the legal framework for the protection of minority shareholder interests have been witnessed in Kenya since the enactment of the Companies Act No. 17 of 2015. According to the *World Bank Survey* of 2016 Kenya was ranked at number 112 out of the 189 countries in the world when it comes to protecting minority shareholder interests. In sub-Saharan Africa, Kenya was ranked number 17 out of the 47 countries that were surveyed. In the 2017 survey there was a great improvement with Kenya being ranked at number 87 out of the 189 countries globally.[8] In 2020 Kenya's overall performance was at number 120 out of 190 economies of the world.[9]

Against this background, this study analyzes the Kenyan legal framework and commercial environment with regards to affording the minority shareholders the protection of their interests when threatened by the majority shareholders. The study proceeds on the basis that even though the minority shareholders are at liberty to commit to being bound by the terms of the company in which they invest, the law can actually influence an outcome that the parties ought to have registered if they were bargaining.[10] Considered through this lens, it is this study's proposition that, despite contractarianism, the law is still in a position to protect minority shareholders from expropriation by the majority shareholders.

Under the Companies Act of 1962,[11] the minority shareholders were required to prove fraud and at the same time the grounds for winding up a company before they could get a remedy from the courts of law. The Companies Act of 1962 had not codified the rules that established the duties, rights, mandates and responsibilities of the different actors in a company. With this prevailing

[7] Doing Business 2020: Comparing Business Regulation in 190 Economies, 19.
[8] See http://www.doingbusiness.org/data/exploreeconomies/kenya accessed 12 July 2021.
[9] Doing Business 2020: Comparing Business Regulation in 190 Economies, 4.
[10] Talbot L, *Critical Company Law*, Routledge 2008, 194.
[11] CAP 486 of the Laws of Kenya (repealed).

situation whenever minority shareholders raised an issue about the conduct of the directors, the courts resorted to the Common Law rules that held onto two basic principles. First that the courts should not interfere with the internal management of the companies and secondly that the directors owe their duties to the company and therefore only the company is the proper plaintiff and can therefore present a case.[12] The courts in declining invitations to interfere in the internal wrangles and management issues pegged their reasoning on the principle that the shareholders and not the judges have a better stake in making business decisions, and the need to avoid a multiplicity of claims[13] and thus run a-foul of the interests of justice.[14]

In Kenya this dictum was upheld in *Dadani v Manji* where the court held that the only time the minority shareholders were allowed to file a suit on behalf of the company is when there was an illegality that has been committed and not just a mere irregularity that can be rectified at the next general meeting.[15] Further, the High Court in *Affordable Homes Africa Ltd v Ian Henderson & 3 Others*, declined to entertain an application brought by 75% of the shareholders [the majority shareholders], on behalf of the company but lacking a resolution of the board, arguing that the proper agent of the company is the board.[16] In essence, the court held onto the opinion that the board had to take the resolution and have the company lodge the application as the proper plaintiff which would yield an absurd outcome if the intended legal action is directed at challenging the board's conduct.

Despite Section 22(1) of the Companies Act 1962[17] providing for a contract between a member of the company and the company, courts refused to recognize and enforce a finding that a member had a contractual right to compel the company to act pursuant to the constitution of the company.[18]

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[12] Foss v Harbottle (1843) 67 ER 189; where two shareholders Richard Foss and Edward Turton commenced legal action against the promoters and director of the company alleging that they had misapplied the company assets and had improperly mortgaged the company property thus the property was misapplied and wasted. The Court in rejecting the two shareholders' claim held that a breach of duty by the directors of the company was a wrong done to the company for which the company alone could sue. In other words, the proper plaintiff, in that case, was the company and not the two individual shareholders.

[13] Wedderburn, "Shareholders Rights and the Rule in Foss v Harbottle" [1957] *Cambridge Law Journal*, 194.

[14] Musa Misango v Eria Musigire & Others, 1966, EA 390.

[15] Dadani v Manji & 3 Others, Civil Case No. 913 of 2002.

[16] Affordable Homes Africa Ltd v Ian Henderson & 3 Others, Civil Case No. 524 of 2004.

[17] 22(1) "Subject to the provisions of this Act the memorandum and articles shall, when registered, bind the company and the members thereof to the same extent as if they respectively had been signed and sealed by each member, and contained covenants on the part of each member to observe all the provisions of the memorandum and of the articles."

[18] Musa Misango v Eria Musigire & Others, 1966, EA 390; the only recognized individual member's right was in instances where the act complained of injured a member or are either fraudulent or ultra vires.

Under this regime, in instances where the directors had the backing of the majority of the shareholders it was commonplace to have them 'right' their wrongs at the general meeting and therefore leave the minority shareholders to their own detriment.[19] This minority shareholders' detrimental position had long been recognized by the centuries-old English case of *Grant v UK Switchback Railways*.[20] In that case, the court held that since the directors that may have exceeded their powers were ratifiable by the majority shareholders they could not be the subject for the minority shareholders.

The enactment of the Companies Act 2015 has expanded the business space and made it easy to start and run companies in Kenya.[21] The new companies' regime has heralded a host of changes within this corporate sector. The new Act enshrines the duties of directors,[22] and derivative suits,[23] among other key departures from the former regime. However, despite the commendable progress made in this corporate sector that has attempted to guarantee the protection of the interests of minority shareholders through the various avenues such as derivative suits, these avenues seem to provide inadequate safeguards. The corporate feature of the company being a fictitious separate legal personality and the corporate veil under which the affairs of the company are managed have hampered the utilization of these legal safeguards for the protection of the interests of the minority shareholders. For instance, first, minority shareholders are unlikely to draw maximum benefits through derivative suits due to the conditions that have the potential of barring any claims that have since been ratified or authorized by the company through its organs such as the annual general meeting.[24] Secondly, the requirement that a claimant has to demonstrate a locus standi[25] and prima facie[26] case in order to be granted leave to institute proceedings may hamper the lodging of derivative actions.

This study delves into an analysis of the legal framework enacted in Kenya for the governance of companies with a specific focus on the protection of the minority shareholders. The analysis widely

[19] Smith v Craft (No 2) [1988] Ch. 114.
[20] [1888] 40 Ch 135 (CA).
[21] Companies Act (Act No. 17 of 2015).
[22] Sections 140-147, *Companies Act* (Act No. 17 of 2015).
[23] Part XI, *Companies Act* (Act No. 17 of 2015).
[24] Section 241(1)(c) *Companies Act* (Act No. 17 of 2015).
[25] In the Matter of CMC Holdings Limited [2012] eKLR.
[26] Tosh Goel Vedprakash v Moses Wambua Mutua and Rabbit Republic Limited [2014] eKLR in this case the court stated that the evidentiary threshold placed on the plaintiff at the leave stage is one of fraud on the company and not full proof of the fraud having taken place.

discusses the Companies Act, the enabling legislation enacted under the Companies Act, the Capital Markets Act to the extent that it provides for the listing conditions aimed at protecting the minority shareholders and caselaw. Even though the Insolvency Act is relevant to the protection of minority shareholders, the study does not consider the Act since the case study discussed in Chapter Four was that of a solvent company. In analysing the legal framework as entailed in these statutes, the study adopts a contractarian perspective in establishing their adequacy or inadequacy in protecting interests of minority shareholders. The contractarian theory is discussed in perspective in Chapter Two of this study.

From the onset, the study appreciates that there exists a mismatch in the interests of the majority shareholders and the minority shareholders. The situation is exacerbated in situations where controlling shareholders also double up as the directors of the companies. The mismatch of interests leads to the severing of the interests of the minority shareholders since they many times fail to raise the quotas required to make impactful decisions.

It is the argument of this study, that some of these legal conundrums that have led to the oppression of the minority shareholders, within the realms of corporate governance despite the various avenues provided under Common Law and now in Statute Law, are attributable to the company law principles of separate legal personality and corporate veil.[27] The study briefly highlights the concept of separate legal personality and corporate veil below.

1.2 The Concepts of Separate Legal Personality and Corporate Veil

Separate legal personality is one of the most fundamental features of a company. The principle refers to the idea that the owners of a company are separate from the company.[28] This also implies that companies can sue and be sued in their capacities as legal persons. Some of the benefits that come with this concept of companies being separate legal entities include the fact that they have a limited liability, the existence of perpetual succession and that the wide capital base which comes from not just the subscriptions of the majority and minority shareholders but also prospective investors should the company go public.[29] In instances where there is a single controlling

[27] Aron Salomon v Salomon & Co. Ltd [1897] AC 22.
[28] '"Individual Autonomy in Corporate Law" by Elizabeth de Fontenay' <https://scholarship.law.duke.edu/faculty_scholarship/3907/> accessed 13 June 2021.
[29] Section 2 *Companies Act* (Act No. 17 of 2015).

shareholder, there is a clamor to treat the company and its shareholder as indistinguishable.[30] In which case, the severability of the company from the director/shareholder ceases to exist since the company being an artificial person its decisions are only attributable to the only natural person that happens to be the sole shareholder and director.

Borrowing from the separate legal personality of a company, there is created a contractual relationship between the company and its shareholders when they subscribe to its articles of association. The creation of this relationship empowers the company to sue its shareholders for failure to abide by their contractual commitments, for instance, remitting of the subscribed shares' capital when called up. The attractiveness of companies for investment is based on the asymmetry between the risks and rewards that accrue to the shareholders i.e., the shareholders have no limitation as to the benefits that accrue to them when the company is thriving but have a limitation as to the risks that they assume which are limited to the amount of shares they have subscribed to.[31]

Considered differently, company law is at the intersection of the law and economics. As a result of this interdisciplinary feature, there lies the reason why the separate legal personality principle has been entrenched in corporate law. Proponents of an economic approach to companies argue that what matters most is not the separate legal personality of the company.[32] Instead, the proponents consider the company from the business perspective, where the decisions are entered into voluntarily making it operate as a 'nexus of contracts.' The proponents essentially consider the company as a market where the buyers and sellers engage in voluntary exchange.[33] The arguments put forth by the proponents are flawed in a sense that they consider the market as a perfect one, which requires no level of protection. They presume that market actors have bargaining power. No matter the perspective and the level of significance accorded to the principle of separate legal personality, it is the position of this study that there is a place for corporate law to regulate the conduct of the parties. This position is supported by the fact that the market does

[30] Swynson Ltd v Lowick Rose LLP [2017] P.N.L.R. 18.
The holding in this case arises a question as to whether the rule and holding in the Salomon case is slowly but surely being vacated?

[31] Paul L, Sarah W, Christopher H, *Principles of Modern Company Law*, 2021, 139.

[32] Blumberg, *The Multinational Challenge to Corporation Law: The Search for New Corporate Personality* (New York: Oxford University Press, 1993) 3-25.

[33] Easterbrook FH and Fischel DR, *The Economic Structure of Corporate Law* (Cambridge, Mass.: Harvard Univ. Press, 1991) 8-22.

not inherently have a balanced bargaining power and thus the minority shareholder is likely to be exploited.

On the other hand, the corporate veil is somewhat similar or related to what the concept of separate legal personality encompasses. It is a concept that distinguishes the identity of a corporation from that of its members.[34] The primary significance of the corporate veil is the fact that it shields through an iron curtain the members from certain liabilities that may arise as a result of the actions of the company's management.[35] Under this concept, the shareholders and to some extent the directors, are often protected from the acts of companies. There are, however, certain scenarios both within the Kenyan statutory legal regime and the Common Law regime that can lead to the piercing of the corporate veil.[36] Some of these include situations when handling offences of fraudulent dealings,[37] when investigating company ownership, when handling group accounts and when an agency relationship exists between a parent company and a subsidiary.[38]

Equally, as the shareholders enjoy the benefits that accrue due to the limited liability feature that borrows from the fictitious separate legal personality of the company, so does their ability to influence the decisions of the company also arise. The higher the stake held within a company the higher the ability to influence the decisions of the company. This state occasions the majority versus the minority shareholder situation. In instances where the majority shareholders also happen to be a controlling shareholder and therefore explicitly or implicitly influences the business decisions of the company, the information asymmetry between the majority and minority shareholders arises. In essence, the minority may not have access to information that can enable them to closely monitor the happenings and the transactions of the company to safeguard their interest and require the timely piercing of the corporate veil in order to stem any possible infringements of their interests within the corporation.[39]

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[34] James W and Di Gioia M, *Lifting, Piercing and Sidestepping the Corporate Veil*, Guildhall Chambers & Gardner Leader Solicitors, UK.

[35]'Buyout Deal to Thicken Mask on KenolKobil Owners' Faces' (*Business Daily*) <https://www.businessdailyafrica.com/bd/corporate/companies/buyout-deal-to-thicken-mask-on-kenolkobil-owners-faces--2009378> accessed 13 June 2021.

[36] Muchiri JW, '*Internationalisation: Foreign Market Entry and Operation Strategy by KenolKobil Limited*' 49 [*Masters Dissertation, University of Nairobi, 2018]*.

[37] Gilford Motor Company v Horne, [1933] 1 CH 935.

[38] DHN Food Distributors Ltd v Tower Harmlet LBC, [1976] 1 WLR 852.

[39]'"Individual Autonomy in Corporate Law" by Elisabeth de Fontenay' <https://scholarship.law.duke.edu/faculty_scholarship/3907/> accessed 13 June 2021.

A holistic understanding of the separate legal personality concept demonstrates that it is largely in favor of the majority shareholders than the minority shareholders in terms of safeguarding of interests.[40] Given that the concept separates companies from their shareholders and bestows on them certain rights and liabilities, the infringement of rights by any person who fails to honour duty or execute a contract can attract a suit from a company to enforce its rights. The decision to start such litigation, however, usually comes from directors who mostly act in the best interests of the majority shareholders. The implicit actions that favor the majority shareholders may be attributed to the fact that they hold the right of ratification of actions of directors. The directors must pass a resolution of the board to invoke the company as a plaintiff before any court of law. It remains highly unlikely that the directors will pass a resolution to lodge a suit where they are likely to be put on their defense and/or have an adverse judgment passed on them.

Towards this end, the study analyzes the adequacy and efficiency of the Kenyan legal framework for the protection of the interests of the minority shareholders. The study considers the current legal framework in light of the concepts of separate legal personality and the corporate veil. The study considers if the two concepts facilitate the protection or the infringement of the interests of minority shareholders. Ultimately, this study conducts a case study on KenolKobil Limited.[41]

1.3 Brief Background and Facts of the KenolKobil Case Study

The Kenya Oil Company (Kenol) was established in the year 1959 and became a listed company at the Nairobi Securities Exchange (then Nairobi Stock Exchange) the same year.[42] In 1986 Kenol and Kobil Petroleum Limited[43] acquired Mobil Oils through a share swap and commenced joint operations. In 2008 Kenol acquired 100% of shares in Kobil Petroleum and therefore merged under the trade name KenolKobil.[44] On 24th October 2018 Rubis Energie served the board of directors

[40]Bayern S, Burri T, Grant TD, Hausermann DM, Moslein F, Williams R. "*Company law and autonomous systems: a blueprint for lawyers, entrepreneurs, and regulators*." Hastings Sci. & Tech. LJ 9 (2017): 135.
[41] KenolKobil Annual Report & Financial Statements- 2018 available at < 2018 KENOL.pdf (cma.or.ke)> accessed 23 October 2021.
[42] https://kenyanwallstreet.com/kenolkobil-company-analysis/ accessed 20 June 2021.
[43] A Delawere registered holding company.
[44] KenolKobil Annual Report & Financial Statements- 2013 available at < 2013 KENOL.pdf (cma.or.ke)> accessed 20 October 2021.

of KenolKobil Plc with a Notice of Intention to take over the KenolKobil.[45] However, the takeover journey faced several legal headwinds and hurdles, among them allegations of insider trading.[46]

The major shareholders in KenolKobil were Wells Petroleum Holdings with a 24.9% shareholding, Petrol Holdings with a 17.34% shareholding, Highfield Ltd with a 12.46% shareholding and Chery Holding with a 7.8% shareholding. Cumulatively, as reported in the dailies the estate of Nicholas Biwott owned the majority stake through proxies at 63%.[47] The majority stake is owned by the top four majority shareholders all operating under various institutional names but, in reality are allegedly proxies of the former Energy Minister Nicholas Biwott.[48]

The other shareholders that cumulatively can be summed up as the minority were those that owned below ten million shares and they were eight thousand seven hundred and fifty-seven (8757) shareholders.[49] The acquirer_ Rubis Energie was founded in France in 1990 with three business specializations i.e., the distribution of petroleum products such as oil fuel and aviation fuel; support and services and storage through its subsidiary Rubis Terminal. The firm experienced exponential growth since 2000 with expansions into Africa, Europe and the Caribbean. Rubis is currently a major fuel distributor in Kenya since it acquired the assets and the 1,145,757,700 shares in KenolKobil Plc in March 2019[50] and later Gulf Energy Holdings in November 2019.[51]

The study uses the KenolKobil case for contextualization of the discussion. As highlighted in the Limitation of the Study in Chapter One, this study recognizes that some of the information on the KenolKobil takeover is no longer available. The unavailability is partly attributed to the fact that the company's takeover has since been consummated. The study will therefore use the available information.

[45] The Notice of Intention is issued pursuant to Regulation 4(3) of the Capital Markets (Take-Overs & Mergers) Regulations, 2002. <https://www.kbc.co.ke/kenolkobil-gulf-energy-merger-given-go-ahead/ accessed 20 June 2021.>
[46] Aly Khan Satchu v Capital Markets Authority (2019) eKLR
[47] Unmasking the figures behind sale of KenolKobil available at < Unmasking the figures behind sale of KenolKobil - The Standard (standardmedia.co.ke)> accessed 20 October 2021.
[48] Why is Biwott selling KenolKobil? Power, Politics and Money in East Africa available at < Why is Biwott selling KenolKobil? Power, politics and money in East Africa - The East African> accessed 20 October 2021.
[49] KenolKobil Annual Report & Financial Statements- 2013 available at < 2013 KENOL.pdf (cma.or.ke)> accessed 20 October 2021.
[50] Annual Report & Financial Statements for the Year Ended 30 June 2019, 51.
[51] <About Us | Rubis Energy Kenya (Rubiskenya.com)> accessed 20 October 2021.

1.4 Problem Statement

The general framework of corporate governance favours the bestowment of powers and duties on the board of directors to make the day-to-day decisions that affect the company. There is a presumption that the directors will act in the best interest of the shareholders, who are the real owners of the company. However, there are instances where the majority shareholders may 'right' the wrongs of the board of directors to the detriment of the minority shareholders. As a result, the Companies Act entrenches avenues for the protection of the minority shareholders among them a derivative action and stipulates the conditions through which these avenues can be utilized.

However, the principles of separate legal personality and corporate veil have hampered the effective and timely utilization of these avenues for the protection of their interests. This study interrogates the impact of these principles on the contractual nature of the relationship that exists between the company and the minority shareholders. In so doing, the study considers how the two principles have hampered the timely invoking of these avenues for the protection of the interests of the minority shareholders in corporate entities. The study utilizes the case study of KenolKobil to contextualize the discussion.

1.5 Statement of Objectives

The overall objective of the study is to interrogate the impact of the principles of separate legal personality and corporate veil in the pursuit, by minority shareholders, of the avenues provided in the legal framework for the protection of the interests of minority shareholders. The interrogation is considered based on the contractual relationship between the company and the minority shareholders.

This overall objective will be realized through the following minor objectives;

a. To investigate the theoretical justifications for protecting the interests of minority shareholders in light of the separate legal personality of companies.
b. To analyse Kenya's legal framework for corporate governance to determine the effectiveness of its provisions for the protection of minority shareholders in light of the separate legal personality of companies.

c. To analyze the impact of the principles of separate legal personality and corporate veil on the implementation of the legal provisions for protection of minority shareholders in Kenya.

1.6 Research Question

The central research question that this thesis responds to is, does the application of the principles of separate legal personality and corporate veil contribute to the protection or the infringement of the interests of minority shareholders? In response to the question, the research asks:

a. What are the theoretical justifications for protecting the interests of minority shareholders in light of the separate legal personality of companies?
b. What is Kenya's legal framework of corporate governance and the effectiveness of its provisions protecting the minority shareholders in light of the separate legal personality of companies?
c. What is the impact of the principles of separate legal personality and corporate veil on the implementation of the legal provisions for protecting minority shareholders in Kenya?

1.7 Hypothesis

The principles of separate legal personality and corporate veil restrict minority shareholders' right to utilize legal protections afforded by law to protect their interests.

1.8 Theoretical Framework

This study is conducted through the fiction and contractarian theories of corporate law. The study analyzes the propositions averred and the criticisms advanced against each of the theories. The study proceeds on a justification for the departure from the strict application of neither of the theories in order to advance efficient protection of the interests of minority shareholders. The study argues that the fiction theory propagates a fictious invisible and intangible separate legal personality that leads to flawed and unethical endings. As a result, the study proceeds with the contractarian theory in order to adequately protect the interests of minority shareholders. These theories are discussed in detail in Chapter Two of the Study.

1.9 Significance of the Study

The Kenyan legal framework [Companies Act No. 17 of 2015] for companies is fairly new and there is scant scholarly commentary on the subject. In particular, there is less analysis on the protection of the interests of minority shareholders from the contractual theory perspective. Equally, the Act is fairly recent and therefore there has not been much litigated on this particular subject. As such, this study is important to legislators working towards the amelioration of deficiencies in Kenya's company law and other laws on securities through the legislative. The findings of the research also enlighten minority shareholders on the nature of the protection they enjoy under the law and the inefficiencies that there exists.

1.10 Literature Review

This thesis acknowledges that different scholars and authoritative jurists have averred significant propositions regarding the protections of interests of shareholders. The study reviews extensive literature throughout the thesis. The study builds on the general propositions within the context of the role played by Kenya's legal framework Companies Act and the Capital Markets Act, in protecting the interests of minority shareholders. The following part, therefore, reviews the works of selected scholars- *Le Talbot, Mocha* and *Lucian* over the subject and sheds light on the extent to which this thesis shall build upon the same.

In his critical approach to company law, *Le Talbot* rationalizes how the protection of minority shareholders is important to corporate governance.[52] He avers that minority shareholding is only attractive in an economy governed by company law that encourages and protects wide share dispersal.[53] Therefore, it is the role of company laws to protect the economic efficiency of minority rights by controlling businesses in which minority shareholders are credited to controlling owners pursuing self-interests.[54] He anticipates that company law coupled with the quality of its enforcement by courts and authorities should ideally serve to protect minority shareholders based on their vulnerability to majority shareholders. *Le Talbot*, further balances this off citing that the law can influence an outcome that the majority and minority shareholders ought to have registered if they were bargaining at the point of signing the articles of association. However, the author falls

[52] Talbot L, *Critical Company Law*, Routledge Cavendish, 2008, 194.
[53] Talbot L, *Critical Company Law*, Routledge Cavendish, 2008.193.
[54] Talbot L, *Critical Company Law*, Routledge Cavendish, 2008, 194.

short of discussing how the principles of separate legal personality and corporate veil can hamper company laws from effectively protecting the interests of minority shareholders. This thesis therefore proceeds on this trajectory by conducting an analysis of how these principles have restricted the utilization of the various avenues provided for by corporate law for the protection of the interests of minority shareholders.

Mocha in his thesis presents a case for the protection of minority shareholders.[55] The author argues his case based on the repealed Act. *Mocha* bases his argument for the protection of minority shareholders on their inability to enforce criminal and civil laws against directors, a transplant of a corporate structure from other jurisdictions and not adapting it to the local demands. Whereas *Mocha* bases his argument on a general perspective of the inadequacies of corporate law and is comparative in nature, this study narrows its focus to the two principles of separate legal personality and corporate veil and their hindrance to the protection of minority shareholders.

Lucian Arye[56] makes a case for the empowerment of shareholders when it comes to them having a say in the management of the company. *Lucian Arye* calls for the reconsideration of the concept of power separation between the shareholders and the management of the company. *Lucian's* proposition is informed by the traditional approach of corporate governance that excludes shareholders from making major decisions that affect the institution that they have invested in. He argues that the separation is not in the best interest of the shareholders and calls for the disruption of the management's monopoly in the making of major corporate governance decisions and instead advocates for the involvement of the shareholders in the initiation and passing of those decisions.

Lucian details the type of corporate decisions in which the input of the shareholders needs to be considered from the onset. *Lucian* argues that shareholders need to be involved in the 'rules-of-the-game' decisions that alter the constitution of the company. *Lucian* posits that involving the shareholders in this type of decisions will ensure that the company remains relevant to the desires and visions of the shareholders. The second decision that shareholders need to initiate is the, 'game ending' decisions, these are the decisions that have the potential of restructuring the company through the corporate restructuring avenues of mergers and acquisitions, selling out, squeezing out, dissolutions, *et cetera*. Finally, Lucian makes a case for the involvement of the shareholders

[55] Mocha TM, "The legal protection of minority shareholders: a comparative analysis of the regulatory frameworks of Kenya and the United Kingdom." [*Master of Laws Dissertation, University of Nairobi, 2014]*.
[56] Lucian B, 'The Case for Increasing Shareholder Power' *Harvard Law Review*, 2005, 833.

in the 'scaling-down' decisions. These decisions include those that will culminate in the reduction of the size of the business through mandating a distribution.

However, *Lucian* concentrates on shareholders as a collective unit. Even though he makes a case for shareholders in general to be involved in the various decisions of the company, he fails to recognize the unique position the minority shareholders find themselves in. This study proceeds to contribute to knowledge through analyzing the unique position of the minority shareholders with regards to decisions that may infringe on their interests. The study proceeds on the proposition that the majority shareholders more so in instances where they are indistinguishable from the company utilize the principles of separate legal personality and corporate veil to the detriment of the minority shareholders.

1.11 Research Methodology

This research primarily applied the doctrinal research methodology. The study conducted desktop research which that entailed a review of the relevant primary sources e.g., statute law, case law and regulations, secondary sources such as books, journals, reports and other available literature on the concept of the corporate veil and separate legal personality of companies, the contractarian theory of corporate governance and its application to the protection of the interests of minority shareholders. The research also relied on secondary data from internet sources and electronic law reports to present the case study of the events leading to the takeover of KenolKobil Limited and its rebranding into Rubis.

The choice of KenolKobil is based on the reason that the majority shareholders reportedly had their identities concealed under institutional shareholding and used proxies in the takeover. The thesis used the UK and USA for best practices. The choice of the UK was based on the fact that the Companies Act of Kenya of 2017 is a transplant of the UK's Companies Act of 2006. Further, the UK as a member of the Commonwealth Kenya greatly borrows from its legal foundations and precedents. Additionally, the choice of the USA was primarily because the country has gained international repute as a prototype of good corporate governance e.g., the State of Delaware. The study therefore borrowed insights from these best practices to propose possible hybrid reforms fitted for the Kenyan jurisdiction in order to improve the protections accorded to minority shareholders in corporate entities.

1.12 Limitations of the Study

The study proceeds bearing in mind two possible limitations. First, the study acknowledges that the Companies Act is fairly recent and thus it has not been litigated and accorded maximum judicial interpretation. As a result, the study refers to English case law in order to support its proposition or critique the provisions of the Companies Act No. 17 of 2015. Secondly, the study proceeds on a possibility of a limitation of information on the KenolKobil case study. As a result, the study relies on secondary sources and credible internet sources for information on the case study. All in all, the study endeavors to be authentic and provide detailed analysis and support all its propositions as far as possible.

1.13 Chapter Outline

The following thesis is presented in the order of the following chapters:

Chapter One

This chapter introduces the research by initially setting out the background upon which the study is based before citing the statement of the problem and spelling out the objectives of the study. This part also highlights the research questions that the study answers and advance the hypothesis that the study set out to prove or disprove. The chapter also presents a brief summary of the case study that is analysed in Chapter Four. The chapter spells out the research methodology adopted to conduct the study and outlines the limitations to the process of research and analysis.

Chapter Two

This chapter sets out the theoretical framework that defines the research. It analyses the fiction theory in order to point out the flawed and unethical nature of its propositions and then proceeds to utilize the contractual theory as the lens through which to gauge the efficacy of the various protections put forth for the protection of minority shareholders. Within the discussion the chapter discusses concepts that underpin the need to enlarge and rethink the protection accorded to the interests of minority shareholders. The chapter underscores the points of departure from the classical contractual relationship between the company and the minority shareholders and makes a case for the intervention of corporate law in the protection of the interests of the minority shareholders.

Chapter Three

This chapter critically analyzes Kenya's legal framework to the extent that it protects minority shareholders against majority shareholders. The analysis is premised on the contractual relationship between the company and the minority shareholders. The chapter also appraises the legal framework based on its efficacy in protecting the interests of minority shareholders in the face of company restructuring. This part therefore appraises the performance of the legal framework on protecting the interests of minority shareholders through mechanisms it establishes. The chapter also considers the best practices in the protection of minority shareholders in corporate entities in the UK and USA. The chapter points out the inadequacies and inefficiencies of the provisions analysed in the context of contractarian theory.

Chapter Four

Chapter Four undertakes a case study of KenolKobil Limited now trading as Rubis, taking into account the events leading to its acquisition. This part contextualizes the role of the Kenyan legal framework in protecting the interests of minority shareholders based on mechanisms that were invoked in the light of the company's takeover. The chapter also contextualizes the principles of separate legal personality and corporate veil. In so doing the chapter makes a case for the departure from the classical contractarian relationship between the company and the minority shareholders and advocate for the enhanced intervention of corporate law to protect the interests of minority shareholders.

Chapter Five

This chapter concludes the study and puts forth the recommendations that will fill in the loopholes identified in the analysis.

CHAPTER TWO: THEORETICAL JUSTIFICATIONS FOR PROTECTION OF THE INTERESTS OF MINORITY SHAREHOLDERS

2.0 Introduction

Chapter One sets the background against which this study is based. The Chapter highlights the revolution of the avenues provided previously in English Common Law and now codified in statute for the protection of the interests of minority shareholders. Chapter One considers briefly the

principles of separate legal personality and corporate veil and how they might hinder the invocation of protective measures such as derivative actions. Chapter Two builds on this background through the setting of a theoretical framework on which the study was conducted. The chapter analyzes the fiction theory of corporate personality. The theory will help in proving a proposition of this study that the distinction of the personality of the company from that of the owners is flawed and unethical to the extent that it may lead to laxity and dishonesty from the controlling shareholders.

Ultimately, the current chapter analyzes the contractarian theory with a specific focus on the contractual relationship between the company and the minority shareholders and the extent to which these two principles have rendered the relationship incapable of protecting the interests of the minority shareholders. Consequently, the chapter makes a case for the departure from the classical contractarian relationship in order to allow corporate law to enhance the protection of minority shareholders' interests.

2.1 Fiction Theory

The fiction theory of corporate personality is based on the fundamental difference between the natural person that exists in the form given to them by God and the artificial person that is a creature of the law.[57] The actions of a natural person are as a result of the volition and will of the human intellect while on the other hand the actions of the artificial person are those of another. The central argument of the fiction theory proponents is that all human beings are natural persons. However, there exist artificial persons that are created by the law possessing subjective rights.[58] The main proponent of the fiction theory is considered to be Pope Innocent IV who propounded that the company is a legal, artificial, invisible and intangible entity.[59] The other proponents of the fiction theory are *Von Savigny*, *Coke*, *Blackstone* and *Salmond*.

In discussing and analysing the fiction theory of corporate law, *Stephen Griffin,* avers that a perusal through the *Salomon* case which crystalized the averments of Pope Innocent IV showcases the

[57] Laufer WS, *Corporate Bodies and Guilty Minds: The Failure of Corporate Criminal Liability* (University of Chicago Press 2006) 50.
[58] Von Savigny FK, *Jural Relations; Or, the Roman Law of Persons as Subjects of Jural Relations: Being a Translation of the Second Book of Savigny's System of Modern Roman Law* (Wiley and Sons 1884) 181-204.
[59] Pope Innocent IV reigned between 1243-1254 and is believed to have propagated the company as an artificial legal person in the 13th Century.

departure from the conventional equity and fairness that the House of Lords had come to be known for and the adoption of the flawed and unethical principle of legal personality.[60] The author argues that the House of Lords intended to give credence to the principle of separate legal personality at all costs at the expense of undermining the welfare and justice of the creditors.

The arguments raised in the fiction theory of corporate law render the owners of the corporation as mere objects. It depersonalizes the shareholders.[61] The alienation of the corporation due to the aspect of possessing a fictitious separate legal personality relieves the owner of the values that are associated with the ownership of property.[62] The principle essentially converts private ownership that the proprietor of the company intentioned while investing their resources into corporate ownership. With the changed ownership comes the appropriation of actions performed by those charged with the responsibility of governing the corporate entity. Consequently, the entity that was envisioned and incorporated by the shareholders becomes an object that assumes a completely different character distinct from the owners.[63]

In essence the fiction theory of corporate law can be faulted and criticized from several fronts. The principle that it developed and which came to be solidified in the *Salomon* case has a potential for abuse. Firstly, the principle runs the risk of creating entrepreneurs that fail to pay much care, diligence and honesty in dealing with third parties under the veil of the company being a separate legal entity. Secondly, the incidental features of the company that arise from the separation of legal personality such as limited liability, may create scenarios where certain majority shareholders do not pay maximum attention to the interests of the minority shareholders and the overall success of the company since their liabilities are limited to their unpaid up share capital. In the end, there is a dangerous and economically unviable situation where companies are promoted and managed by

[60] Stephen G, *Company Law: Fundamental Principles* (4th edn, Pearson 2006) 23.
The unethical vices in the decisions are best answered through the posing of the following questions: is it fair and justifiable to let the creditors of Salomon go empty handed because of the fictional virtues of separate and artificial personality of a company? Did the judges consider whether Salomon was in a position to pay up his debts from other sources without much hassle? Did the court consider whether the credit advanced to Salomon constituted the entire lifetime resources of his creditors?
[61] Nkem, A, and Ikenga KE. "*Jurisprudence of Corporate Personality: Rethinking the Paradox of Separate Personhood in Fiction Theory*." African Journal of Law and Human Rights 2 (2018) 7.
[62] Berle AA and Means GC, *The Modern Corporation and Private Property* (2nd Edn, Harcourt 1968) 66-67.
[63] Paddy I et al, '*The Conceptual Foundations of Modern Company Law'* (1987) 14 J Law and Soc 149, 150.

persons that have little concern for success but serve personal interests which are both flawed and unethical.[64]

This study utilizes the propositions and criticisms advanced in this theory to illustrate how inherently the principle of separate legal personality and its attendant virtues of lifting the corporate veil and limited liability have been utilized to curtail interests of among others minority shareholders. The distinction of personality which in essence waives personal liability creates a buffer that can be exploited by the controlling shareholders for the advancement of their personal and selfish interests. It is the overall argument of this study that notwithstanding the exceptions to the principle of separate legal personality through the lifting of the corporate veil, these exceptions are self-defeating and do not accord much protection to the interests of minority shareholders.

Consequently, this study considers the contractarian theory to the extent that it creates an enforceable contract between the company and the minority shareholders. The contractual relationship established as juxtaposed with the justifications for departure creates an avenue that corporate law can use to protect minority shareholders.

2.2 Contractarian Theory

A classical contract is defined as a bilateral agreement consisting of an exchange of promises through a process of offer and acceptance with an intention of creating a binding deal. The acceptance of an offer by the offeror consummates the contract and thus makes it binding.[65] A classical contract operates on the basis of freedom of contract, based on the assumption that the parties have equal bargaining power that affords a level playing field.[66] However, with a dynamic business world in the 21st century there is a recognition of the existence of asymmetrical bargaining power field and therefore a need to develop rules that are aimed at protecting the weaker party.

Ronald Coase is a proponent of a free-market economy that is self-regulating. *Coase* argues that legal rules do not matter for economic outcomes. *Coase* argues that individuals should be allowed to freely contract without the intrusion of the law and regulators provided the enforcement of the contracts should be nil at no cost.[67] *Coase* avers that the law does not matter in a contractual

[64] Alastair Hudson, *Understanding Company Law* (Routledge 2011) 3.
[65] David O. and Martin D, *Sourcebook on Contract Law*, 2000, 1.
[66] David O, and Martin D, *Sourcebook on Contract Law*, 2000, 2.
[67] Johnson S. "*Coase and corporate governance in Latin America*." (2000) 114.

economic situation such as the relationship between the company and the minority shareholders. Borrowing from the *Coasian* school of thought, *Easterbrook and Fischel* argue that firms can protect investors through a variety of mechanisms that are efficiently executed among themselves as opposed to using the law that may complicate the arrangements.[68] However, *Simon Johnson* in his article, '*Coase and Corporate Governance in Latin America'*, criticizes the *Coasian* position averring that in the absence of strong domestic laws, an efficient judiciary and a tough but fair regulator, there will be no avenue to protect investors.[69] *Simon Johnson* makes a case for there to be legal rules, by arguing that in countries with a civil law tradition there is weaker protection for minority shareholders.[70]

The contractual theory of corporate governance is founded on the proposition that the relationship that exists between the company and the shareholders as a collective unit is contractual in nature.[71] As such, it is anticipated that the market forces shall force corporations to establish optimal corporate contracts with promises for effective corporate governance for the benefit of shareholders. Shareholders are, therefore, presumed to accept these contractual terms when they accept to subscribe to shares, which accords them a unit of ownership to the company. It is anticipated that such contracts would bear the promise of effective corporate governance that guarantees owners of the corporation value for their money.[72] It is for these reasons that the theory indicates that the corporation, when going public, will tender corporate contracts that entail prudent corporate structures that are of significant utility to investors.[73]

Considering the study through the lens of contractarian theory, the chapter considers the application of the contractual relationship between the minority shareholders and the company. The study points out the points of departure of the strict application of the contractual relationship based on inter alia, the information asymmetry between the controlling majority and minority shareholders. The unique and flexible nature of the contract that is as a result of the company's constitution being changed from time to time through resolutions, that are in most cases a reflection

[68] Easterbrook FH and Fischel DR, *The Economic Structure of Corporate Law*, Harvard University Press, Cambridge, (1991).
[69] Johnson S. "*Coase and corporate governance in Latin America*." (2000) 116.
[70] Johnson S. "*Coase and corporate governance in Latin America*." (2000) 116.
[71] Klausner M. '*The Contractarian Theory of Corporate Law: A Generation Later*.' 2006 *Journal of Corporation Law* 21, 782.
[72] Easterbrook FH and Fischel DR. *The Economic Structure of Corporate Law*. *(*Harvard University Press, *1996)*15.
[73] Easterbrook FH and Fischel DR. *The Economic Structure of Corporate Law* 15.

of the majority's view, the limited or negligible possibility of the minority having their representation/views incorporated into the contract between the company and themselves. The chapter captures certain salient l justifications that underpin the need to legally view minority shareholders as unique thus deserving of better and more efficient standards of protecting their interests. The study takes a position that is different from that of *Coase* who argues for the contractual relationship being divorced from the law and left to the arrangements between the parties.

Contractarianism has been put forth as a rationale for the law imposing certain standards of protection on the minority shareholders. However, there are adequate arguments that can be put forth in making a case for the protection of minority shareholders. For instance, each individual member that signs up for the constitution of the company is presumed to have contractually agreed to be bound by the company's articles of association and the memorandum. The company is thus assumed to have individually contracted with the members. If this is the foundation of subscription to be a member then in instances where an individual has a legitimate basis to believe that the company has been wronged, that member as 'the owner' should be accorded legal avenues to protect the company from harm. Without availing these avenues, the majoritarian dictatorship in the management of companies will stifle economic growth and personal development of the citizens through the oppression of the minorities.

The articles of association of a company can be termed as rules with rights and obligations that shareholders can enforce through legal means. The nature of such contractual rules is that they are entrenched as promises and can only be reviewed by a majority vote that amounts to a resolution of the company. Even though the investors enjoy the leverage to tailor these corporate contracts to suit their needs, corporate law still has a significant role to play. This entails the entrenchment of standard corporate contractual terms that entail the general objective of contract law, to be adopted to the corporation to the extent to which they advance the value of the corporation.[74]

In the context of this study, it is acknowledged that due to information asymmetry and unbalanced bargaining power between the majority and minority shareholders, the freedom of contracting is considerably eroded. The contractual relationship in a corporate body that is involved in business such as a company is primarily dictated by the market exigencies and must adapt to the prevailing

[74] Anand, A. *Shareholder-Driven Corporate Governance*. *(*Oxford University Press, *2020).*

marketplace conditions. The market-mediated contracts are subject to change the contract signed at the subscription of shares through resolutions that require a given quota to pass. The quotas are either an ordinary resolution that requires a simple majority vote of those present and voting[75] or a special resolution that requires a vote of not less than seventy-five percent majority of the shareholders.[76] Suffice it to note that the minority shareholders are at a disadvantage since they can neither raise the ordinary nor the special resolution quotas that make effective decision making in a company. It is the above reasons and the analysis in this study that warrant a departure from the contractual relationship and therefore justify the adoption of corporate law in protecting the interests of the minority shareholders.

2.3 The Impact of Market-Mediated Contract on Minority Shareholders and Justification for Departure from Contractarianism

The assumption that underlies the contract, therefore, is that the corporate contract is market-mediated with the effect that they are socially optimal. This might diminish what ought to be the role of corporate law which is to set out general terms. Hence, it is assumed that states are ordinarily in competition to legislate on corporate laws that maximize the value of corporations for the benefit of domestic corporations as well as foreign investments.[77] Following this assumption, one of the major flaws in the contractarian theory is that most corporate governance structures and mechanisms that differ from one corporation to the next are rarely enshrined within a corporation through contractual commitments, nor are they maintained by any.[78] Further, while going public, it is not in the common practice of public corporations to include issues related to their corporate structures in their corporate charters as part of the legally enforceable contract that prospective shareholders tend to sign up to. Hence, if any of these terms are likely to be of a prejudicial effect to the investors, it would be wrong to assume that they had intended to be bound by them following the implicit entry into the corporate contract while purchasing the shares of the company. The lack of inclusion of a corporation's corporate structure and the fact that the company's brain- the board of directors- is bound to change from time to time through a vote of the majority renders the contractual framework inefficient and potentially detrimental to the

[75] Section 256 *Companies Act* (Act No. 17 of 2015).
[76] Section 257 *Companies Act* (Act No. 17 of 2015).
[77] Moore M and Petrin M. *Corporate Governance: Law, Regulation and Theory. (*Macmillan International Higher Education, *2017).*
[78] Moore M and Petrin M. *Corporate Governance: Law, Regulation and Theory*, 2017.

interests of the minority shareholders. Whereas the minority shareholders signed the contract based on the existing corporate structure and body, any changes effected through an annual general meeting or a special general meeting may potentially change the focus and vision of the company and thus alter the representations.

Secondly, the interpretation of the articles of association and the mode adopted to achieve the duty of promoting a company's success may not always be detrimental to the interests of the minority shareholders. All decisions taken by the corporate body as an artificial entity are binding to the shareholders upon ratification by the majority shareholders. The ratification has the effect of righting the wrongs, if any, of the board and therefore the minority shareholders have no avenue of effecting another decision that will favor their interests. Since the minority shareholders by their very nature cannot raise the required quorum to overturn such a decision taken by the board of directors and ratified by the majority shareholders, there is a justification for the departure from the classical contractarian framework and availing of alternatives to protect their interests.

Further, it is the proposition of this study that at the time of subscription of shares shareholders may lack the necessary awareness of corporate governance structures and mechanisms. This situation is worsened by the fact that even for companies that issue their prospectus, the corporate structures are not part of the in-depth information that is contained there. However, the company cannot be faulted if the shareholders fail to exercise their due diligence, especially since when the prospectus is considered as adequately for informing a prospective subscriber. It is paramount for a prudent subscriber of a company's shares to seek clarity and understand the nature of the business they are about to entangle themselves into. Further, even if the corporate governance structures were to be incorporated in the articles of association, it is now generally accepted that the company constitution is not enshrined in a single document but spread across the many board and company resolutions passed from time to time. Hence, viewed from this perspective, the contractual theory falls short of protecting the minority shareholders' interests.

Additionally, *Davies, Worthington and Hare* propound that a company as an association its constitution is amended by the shareholders in tandem with business needs and commercial environment demands of the time. The amendments many times are influenced by those that have the advantage of a hold-out position in the company. In essence therefore, the minority shareholders subscribe to the company knowing well that their contractual rights as enshrined in

the company's articles of association may be amended [sometimes against their will] by the shareholders acting as a single entity.[79] Amendment of the articles of association is a fundamental feature of a business association that ensures it stays competitive and adopts to the prevailing commercial environment. In essence therefore the law should be made in such a way as to provide for a higher threshold than a special resolution [perhaps require unanimity] in order to amend entrenched provisions of the company constitution so as to safeguard minority shareholders from whimsical adulterations by the majority shareholders. However, the study equally notes that the level of protection that it proposes, for instance, the requirement for unanimity may not serve the best interest of the company. Corporate governance exists to ensure that the success of the company is achieved, and a small minority of the company's shareholders should not be allowed, where reasonable information has been availed and steps have been taken to persuade them to allow the decision, to cripple the pursuance of a course that has attained the majority support.

Another shortfall that befalls the assumption that the corporate contract sufficiently represents the interests of the prospective owners of companies is the uniformity that characterizes various corporate contracts.[80] For instance, countries such as Kenya provide for a template company constitution that during incorporation many corporations would adopt. Hence in reality, most of the adjustments into such corporate contracts often have to be undertaken through popular mechanisms that would at no point be advantageous to the interests of minority shareholders. As such, it would be wrong to assume that various corporate contracts fulfil their contractarian role. Rather, they merely represent the default rules that apply in general aspects of corporate law to the extent that it cannot be said that they fulfill the interests of prospective investors. As such the unique interests that subscribers of companies might be having are left unattended. A classical contract entails the bargaining of the terms of representation. It reflects the meeting of the minds of the parties after a process of offer, counteroffers and acceptance. This is not the case in the situation prevailing between the company and the minority shareholders. There exists an unbalanced level of bargaining power that in most times the company's power prevails. In cases where the company entails a controlling shareholder either explicitly or implicitly as was in the

[79] Davies PL, Worthington S, Hare C, '*Principles of Modern Company Law*.' 2021, 528.
[80] Cobbaut, R and Lenoble, J, *Corporate Governance: An Institutionalist Approach*. (Kluwer Law International, *2003*).

case study that had the majority institutional shareholders as proxies, the company becomes indistinguishable from the biases of the controlling shareholder.

Hence, it is apparent that minority shareholders do not get to play a role in establishing these contractual terms; rather they merely endorse them following their decision to invest in the corporation. Even though there is room through which these contractual terms can be customized, the requirement that this has to be done through a company's resolution does not give minority shareholders any upper hand or control over their own interests. This is considering that such resolutions can only be passed by quotas that minority shareholders might not meet. Hence, minority shareholders are disadvantaged at the point where they need to make such changes in corporate governance that can only be achieved through non-legal mechanisms such as economic or reputational sanctions.[81] Furthermore, the urgency of the need to invest may blur the judgment of the investor to thoroughly scrutinize the contractual terms upon which the company is governed.

Based on this theory and the justifications adduced to warrant a departure from the classical contractual relationship, the role of the law ought to be to place minority shareholders in a position of controlling the terms and conditions under which they anticipate contracting with the managers to protect their interests. One of the ways through which this can be achieved is by establishing rules that require corporate charters availed to prospective investors to contain in-depth information regarding corporate governance structures and strategy of the company.[82] It is at such a point that it would be fair to infer that the contractarian role of these corporate charters has been achieved. Further, this study explores the extent to which the existing legislative provisions that are responsible for the uniformity of corporate governance are expanded to cover a wider scope that sufficiently incorporates aspects that would be important to aid the interests of minority shareholders.[83] Hence, the following study evaluates the role of corporate law in this regard which ought to be towards maximizing value and facilitating contracting especially under terms that would not leave minority shareholders vulnerable.

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[81] Klausner, M. 'The Contractarian Theory of Corporate Law: A Generation Later.' 2006 *The Journal of Corporation Law*. Retrieved from: https://law.stanford.edu/wp-content/uploads/2015/06/31JCorpL779.pdf#:~:text=The%20contractarian%20theory%20posits%20that,a%20company%20initially%20goes%20public accessed 29 July 2021.

[82] Cohn JB., Mitch T, and Aazam V "Quasi-Insider Shareholder Activism: Corporate Governance at the Periphery of Control." *Available at SSRN 2945613* (2020).

[83] Othman S, Jo-Ann Ho, and Ahmed A. "Individual Minority Shareholder Activism Approaches and the Exit-Voice-Loyalty Neglect Model." *International Journal of Business and Society* 20, (2019) 823-839.

2.4 Contractarian Justifications for Protecting Minority Interests

Minority shareholders hold the non-controlling interest in the company. The majoritarian approach to corporate governance through voting rights affects the minorities greatly. However, company law comes to the protection of their interest. Wealth maximization model of corporate governance has since been modified to include wealth distribution in a bid to protect the competing interests.[84] In many instances, the courts have rejected the contractual ideas which surround the relationship of shareholders based on the assumption that they owe the minorities a fiduciary duty to act in good faith and to respect their reasonable expectations.

For instance, in the *David Langat* case, the court had to depart from the contractual agreements between the equal shareholders and even characterize an equal shareholder under the limb of minorities in order to serve the interests of justice. The court proceeded to analyse the situation that was presented before it since despite the applicant owning 50% of the shares, there was no guarantee that he can adequately protect the company from the injurious acts of one of its shareholders. The court said,

> "…*The position which a shareholder in a 50:50 situation finds himself in is no less different from the position that a minority shareholder finds himself in. A minority shareholder is handicapped and frustrated because he can pass no resolution to benefit the company. His views are prone to being trampled upon by the majority and he finds himself hamstrung, unable to do anything on behalf of the company. That position is similar to that in which a person holding 50:50 shareholding finds himself. He is unable to pass any resolution because the other half must accede to it. If the other half does not permit the resolution to pass then the one shareholder is stuck, just as he would be stuck if he was a minority…in our present case, there is strictly no majority and no minority. The person against whom the action is intended is, however, in de facto control of all resolutions, including resolutions to sue. There is no other way that Sunrise Ltd (the company) can put forth any claims separate from having a derivative action filed on its behalf."*[85]

[84] Anupam C, 'Minorities, Shareholder and Otherwise' 2003, 113 *The Yale Law Journal*.
[85] David Langat v St. Luke's Orthopedic & Trauma Hospital & 2 Others [2013] eKLR.

It is worth noting that in the instant case despite the contractual understandings between the two equal shareholders, the court had to classify the applicant as a minority shareholder in order to serve the interests of justice. A question arises then as to whether contractual obligations as envisaged can adequately safeguard the minority shareholders. The case lays bare the need to look beyond the letter of the law and instead invoke its spirit so as to adequately protect the minority shareholders. Further, the case presents yet again the challenges that minority shareholders face in the process of seeking leave to institute a substantive suit on behalf of the company. The onerous process of granting leave may as well occasion an injustice on the part of the minority shareholders. The need to establish a *locus standi* coupled with *prima facie* case may prove cumbersome since many times the information that will be required to establish the latter requirement is in the hands of the board of directors against whom proceedings are about to be lodged. Logically, the board of directors together with most of the shareholders that are likely to ratify and 'right the wrongs' will be hesitant to accord the aggrieved minority shareholders the necessary help and documentation.

The commercial market within which companies operate is an ever-dynamic field. The bargaining power of various actors is dictated by the majoritarian rules of democratic governance. Left to the unmitigated market demands, the minority investors would suffer immensely. The law is enacted in order to facilitate fair trade practices and provide a framework for the growth of industry. In agreeing with the propositions of *Le Talbot* for the entrenchment of mechanisms aimed at protecting minority shareholders, this study makes a case for the proper articulation and enforcement of such laws. The laws should be detailed in subsidiary legislation so as to remove any ambiguity that may be in existence. The minority shareholders already occupy an unbalanced position owing to their little stake in the company that hampers their ability to influence decision making. This is also critical owing to the fact that the rule against courts' interference in the internal management affairs of the company may by the time a detrimental company decision is set aside, have led to the continued subjugation of the minority shareholders.

Arising from the discussion and analysis of both the contractarian theory and its justifications for departure, and the literature it can be concluded that, the justifications for the protection of the interests of minority shareholders are based on the premise that any person intending to invest in a business must bargain for proper protection beforehand.

2.5 Conclusion

In the upshot, the central argument is that the law is necessary to protect minority shareholders although they voluntarily assumed a contractual relationship with the company. The intervention of the law is justified by the inherently unbalanced level of bargaining power and information asymmetry between the majority and minority shareholders. The contractual feature of privity has to be vacated where there is an abuse of this unbalanced bargaining power in order to protect the interests of the minority shareholders. It is at this point that the corporate law should play a greater role in protecting these interests before minority shareholders are disadvantaged by popular mechanisms that would never be in their favor. Therefore, the theory and its shortcomings also provide an essential lens through which this study critically examines the efficacy of the role of corporate law on lifting the corporate veil and setting aside the separate legal personality of the company in protecting the interests of minority shareholders. The contractual safeguards established in law as analysed above fall short of the standards that will safeguard the interests of minority shareholders from the majority shareholders and the board of directors.

CHAPTER THREE: LEGAL FRAMEWORK ON PROTECTION OF MINORITY SHAREHOLDERS

3.0 Introduction

Chapter Two has analysed the contractarian theory that is based on the proposition that there is no need for the law to get involved in setting up protections for minority shareholders. The theory presumes that the contract they sign is entered into voluntarily and therefore affords them enough protection. In its discussion, the study has made a case for the departure from the classical contractual relationship between the company and the minority shareholders. The chapter adduced the rationale for the departure, inter alia, information asymmetry, the unique nature of the contract that can be amended from time to time through the required quotas. It is the inadequacies in the contractual relationship between the company and the minority shareholders that this chapter analyses through the consideration of the legal framework established for the protection of the interests of minority shareholders. Additionally, to a limited extent Chapter Two considered the

fiction theory of corporate law and pointed out the flawed and unethical outcomes that it may portend to the protection of minority shareholders.

This chapter analyses the Kenyan legal framework for companies in terms of how it protects minority shareholders from controlling shareholders. It assesses the provisions on the protection of minority shareholders in the Companies Act, 2015 and the Capital Markets Act, CAP 485A and case law. It investigates the effectiveness of this legal framework in protecting the interests of minority shareholders in the face of corporate restructuring. In answering the questions and objectives of the study, the chapter considers the various provisions considered from a contractarian theory lens in order to establish whether there are efficient remedies for the protection of the interests of the minority shareholders. The study chiefly considers the Companies Act, 2015 as the main Act that enshrines the frameworks for the protection of minority shareholders. Further, the Capital Markets Act is considered to the extent to which it enshrines a framework for the safeguarding of the interests of the minority shareholders. Further, as highlighted in Chapter One under Research Methodology, case law from Kenya and the United Kingdom as well as the best practices from the United States of America have been considered in order to fill in the lacunas identified in the course of analysis.

3.1 The Companies Act, 2015

The Companies Act, 2015[86] is the main legal framework in Kenya that protects the interests of minority shareholders. This Act repealed the Companies Act, Cap 486.[87] The Companies Act, 2015 was enacted to achieve various objectives which include consolidating and reforming the law relating to the incorporation, registration, operation, management and regulation of companies. So far it has been amended seven times by the following statutes: the Finance Act, 2016;[88] the Statute Law (Miscellaneous Amendments) Act, 2017;[89] the Movable Property Security Rights Act, 2017;[90] the Companies (Amendment) Act, 2017;[91] the Statute Law (Miscellaneous Amendments)

[86] The Companies Act, No. 17 of 2015, Laws of Kenya.
[87] The Companies Act, 2015, Sec. 2 (the repealed statute).
[88] The Finance Act, No. 38 of 2016, Laws of Kenya [Amended section 975 (2) (b).
[89] The Statute Law (Miscellaneous Amendments) Act, No. 11 of 2017 [amended sections: 93(9); 245(1) & (2); 468(2); 518; 520(4); 540(1); 558; 560(1); 986(3) & 1024(7)].
[90] The Movable Property Security Rights Act, No. 13 of 2017, Laws of Kenya [amended sections: 3; 111(l); 832(3)(c); 854(1); 882(1) & (2); .886(1)(b) & (2); 886(2); 889(1)-(3); 890(l); 891(1) & (2); 927(5); 975(3) & 1007(2)].
[91] The Companies (Amendment) Act, No. 28 of 2017, Laws of Kenya [amended sections: 3; 27; 58; 77; 85; 90; 93; 94; 123; 135; 146; 147; 151; 153; 162; 210; 245; 246; 304; 308; 328; 329; 344; 393; 416; 441; 442; 443; 444; 463;

Act, 2018;[92] the Statute Law (Miscellaneous Amendments) Act, 2019;[93] and the Business Laws (Amendment) Act, 2020.[94]

Before delving into the specific provisions, it is important to note that since the enactment of the Companies Act in 2015, there has been a tremendous improvement in the protection of the interests of minority shareholders as noted in the background to this study. This improvement is a tremendous boost for Kenya as it strives to become the most competitive investment environment in Sub-Saharan Africa.[95] Kenya has historically prided itself as the Silicon Valley of sub-Saharan Africa and therefore any changes that improve its economic ranking is an endeavor that commends itself for pursuit. The discussion and analysis in this chapter therefore makes a case for an even more improved legal framework for the protection of the interests of the minority shareholders.

3.1.1 Derivative Actions

A derivative action has been defined as, '*proceedings by a member of a company in respect of a cause of action vested in the company and seeking relief on behalf of the company*.'[96] *Mwera J* in *Dadani case* defined a derivative suit as, "… *such actions in company law, minority shareholder(s) feeling that wrongs had been done to the company which cannot be rectified by internal company mechanisms like meetings and resolution, because the majority shareholders are in control of the company, come to court as agents of the 'wronged' company to seek reliefs or relief for the company itself, all the shareholders including the wrongdoers, and not for the personal benefit of the suing minority shareholder(s).*"[97]

Prior to the enactment of the Companies Act of 2015 the route to pursuing a derivative action was under the Common Law system and the exceptions under the case of *Foss v Harbottle*. The dictum in Foss v Harbottle bestowed upon the company the right to sue and be sued in line with its separate

494; 511; 539; 549; 550; 564; 573; 626; 633; 640; 705; 717; 718; 724; 774; 790; 807; 815; 821; Part XXXVI; 974; 975; 978; 997; 1017; 1024; 1026; & Sixth Schedule].

[92] The Statute Law (Miscellaneous Amendments) Act, No. 18 of 2018, Laws of Kenya [amended sections: 5 1(3); 258; 281(2); 721(3); & 721(4)].

[93] The Statute Law (Miscellaneous Amendments) Act, No. 12 of 2019, Laws of Kenya [amended sections: 9(1)(a); 93(1), (2)(c) & 8; 93A; 329(2); 611(2)(a) & (b), & (4)(a) & (b); 615(3)(a)(i) & (ii), (4)(b)(i), (5)(a)(i) & (ii); & 624(3)(c)].

[94] The Business Laws (Amendment) Act, No. 1 of 2020, Laws of Kenya [amended sections:37; 38; 42; & 43.

[95] Mwaura K, Statutory Protection for Oppressed Minority Shareholders in Kenya: Reflections on the Reforms under the Companies Act 2015.

[96] Section 238(1) Companies Act (Companies Act No. 17 of 2015).

[97] Dadani v Amini Akberazi Manji & 3 Others [2004] eKLR.

legal personality. The rule in *Foss –v- Harbottle* provides that *"a company is a separate legal personality, and the company alone is the proper Plaintiff to sue on a wrong suffered by it.*[98] However, in recognition that the company as an artificial person may not sue where the directors are either unwilling or unable to sue, the case developed exceptions that have now gained statutory entrenchment as stated above. Consequently, shareholders were empowered to collectively possess the power to institute litigation even when it has not been enshrined in the company constitution.[99] The shareholders could by a special resolution pass the resolution to institute litigation since this action is equivalent to an alteration of the articles of association [company constitution]. At Common Law an ordinary resolution was and still is deemed to be sufficient to collectively institute litigation.[100]

With time several Kenyan cases restated the principles and the exceptions in *Foss v Harbottle*.[101] These exceptions that were meant to mitigate the harshness of applying the rule include:

- where the company is acting ultra vires; which covered instances where the acts complained of are those beyond the company's powers under the constitutive documents.[102]
- where fraud has been committed on the minority; that covered instances where by virtue of their control over the company it is impossible for the wrongdoers to institute proceedings for fraudulent acts committed against the company.[103]
- where wrongdoers are in control.*[104]*

The action to be commenced through a derivative action had to be in the best interests of the company and without any ulterior motive.[105] Presently, Part XI of the Companies Act, 2015 replaced the common law requirement to fall under the exceptions to the rule in *Foss v Harbottle*. Besides, the Companies Act, 2015 establishes statutory guidelines that guide judicial discretion in granting permission to continue a derivative action. Minority shareholders are granted the

[98] Foss v Harbottle (1843) 2 Hare 461.
[99] Paul LD. Sarah W and Christopher H., 'Principles of Modern Company Law.' 2021, 568.
[100] Danish Mercantile Co. Ltd v Beaumont [1951] Ch. 680 at page 687.
[101] David Langat v St. Luke's Orthopedic and Trauma Hospital Limited $ 2 Others [2012] eKLR.
[102] Bharat Insurance Company Ltd v Kanhaiya Lal, AIR 1935 Lah 742.
[103] Greenhalgh v Arderne Cinemas Limited, 1951 Ch. 286.
[104] Daniels v Daniels [1978] Ch. 406.
[105] See See Ghelani Metals Limited & 3 others v Elesh Ghelani Natwarlal & another [2017] eKLR, Civil Suit 102 of 2017; Rai & Others v Rai & Others [2002] 2 EA 537 & Murii v Murii & Another [1999] 1 EA 212.

protection of instituting a derivative action because majority shareholders generally exercise power over the company and control its affairs.[106] A derivation claim allows a minority shareholder to file a claim on behalf of the company against an insider (whether a director, majority shareholder, or other officer) or a third party whose actions are alleged to have harmed the company.[107] This harm may be the result of a cause of action arising from an action or omission involving negligence, default, breach of duty, or breach of trust by a company director.[108]

A derivative claim is a two-stage process, application for leave and substantive suit. Before filing a derivative suit, it is critical to obtain the permission of the court. This is the essence of the leave application as it is intended to grant the claimant permission to proceed with the claim. The application for leave must be accompanied by written evidence.[109] In this case, the applicant must establish prima facie[110] case and demonstrate that they have a *locus standi* to bring such action.[111] The applicant in a derivative claim is thus required to have some information that can convince a court of law of the existence of facts pleaded and a possibility that the court can enter a decree of guilt should the alleged course of action not be rebutted by the would-be respondents. Based on the information asymmetry suffered by the minority shareholders as discussed in Chapter Two of this study, there may arise several occasions that a derivative claim may abort at the leave stage for lack of information.

In Kenya, the High Court is vested with jurisdiction to grant leave to institute a derivative claim.[112] The leave contemplated under sections 238 and 239 of the Companies Act, is not a condition precedent.[113] This means that the application for leave may be filed prior to or after the filing of the substantive suit. Besides, the application for leave may be filed concurrently with the substantive suit. As in the current framework there are neither procedures nor timelines that have been enacted in respect to the derivative claim application. According to current court practice, the

[106] Part XI, *Companies Act* (Act No. 17 of 2015) & Sultan Hashem Lalji & 2 Others v Ahmed Hasham Lalji & 4 Others [2014] eKLR.
[107] Ghelani Metals Limited & 3 others v Elesh Ghelani Natwarlal & another [2017] eKLR, Civil Suit 102 of 2017.
[108] Section 238 (3), *Companies Act* (Act No. 17 of 2015.
[109] Joffe, V., Drake, D., Richardson, G., Collingwood, T., & Lightman, D., Minority Shareholders: Law, Practice and Procedure, *Oxford University Press*, 2011.
[110] Black's Law Dictionary, 8th Edition, defines '*prima facie'* as sufficient to establish a fact or raise a presumption unless disproved or rebutted.
[111] Section 239-242, *Companies Act* (Act No. 17 of 2015) & Amin Akberali Manji & 2 others v Altaf Abdulrasul Dadani & another [2015] eKLR,Civil Appeal 101 of 2004, para. 39-40.
[112] Section 3, *Companies Act* (Act No. 17 of 2015). [interpretation of the term "Court"].
[113] See Stephen Maina Githiga v Kiru Tea Factory Co. Ltd & Another; [2017] eKLR, Civil Suit 106 of 2017.

application for leave is made through a notice of motion application supported by an affidavit. The substantive suit, on the other hand, is initiated through a plaint. Kenya should enact a procedural framework for derivative claims through the adoption of a procedure that facilitates access to the courts by potential litigants as opposed to making it complex to institute a derivative action.[114] This sieving mechanism is vital because it allows the court to filter out frivolous and fraudulent cases, among others, that would otherwise waste the time of the court. The court only allows meritorious claims after the applicant has established, through evidence, a *prima facie* case with a probability of success. The existence of substantive rules governing this avenue of protecting the interests of minority shareholders will create a contract pre-existing and that shall implicitly by legal fiat form part of the binding agreement that exists between the company and its shareholders at the time of acceding to the company's constitution.

The establishment of procedures for the lodging of derivative suits, the parameters of gauging the merit of a derivative suit, the timelines for consideration and the parties that can institute them will ensure enhanced protection of the interests of minority shareholders. The lack of procedures may have so far disadvantaged many possible claimants for lack of knowledge of the presence of this avenue of protection. Procedural rules are the handmaidens of justice. They lay down the framework, they provide the microscopic details that are required to be addressed so as to ensure that claimants get to tick all the boxes before lodging a claim. So far, the Companies Act has somewhat relaxed the stringent regulations under the repealed Act through the removal of the onerous requirement that the minority shareholders had to prove that fraud had been occasioned on them by the majority shareholder.[115] Today, once the derivative suit is filed and the leave granted to proceed to substantive stage, the wrongs of negligence, default, breach of duty or trust will be remedied, and the company will continue to operate. With the reduced threshold of stringent rules under the repealed act and a timely enactment of procedural rules, the protection of the interests of minority shareholders will without a doubt be enhanced.

Derivative action, like any other commercial case in the courts, attracts court fees. This is one of the many major challenges that it faces. Consequently, prospective litigants must have to consider

[114] Mocha TM., The Legal Protection of Minority Shareholders: A Comparative Analysis of the Regulatory Frameworks of Kenya and the United Kingdom *(Masters Dissertation, University of Nairobi), 2014, 80-81.*
[115] Mwaura K, Statutory Protection for Oppressed Minority Shareholders in Kenya: Reflections on the Reforms under the Companies Act 2015, 211.

the cost of pursuing a derivative action against the wrongdoer who is in control of the company. This fact could be both difficult and discouraging. The existing framework that potentially places the burden of paying the costs of the suit if one loses the case may discourage some minority shareholders, especially those in difficult financial situations, from bringing a derivative action against the wrongdoers of the company who oversee the finances of the company.[116] This necessitates the establishment of guidelines and mechanisms for compensating minority shareholders who initiate derivative actions. This is one of the potential solutions to the problem. It is the proposition of this study that as part of the ways of encouraging the minority shareholders to take part in the corporate governance through the avenue availed by derivative suits, there should be a framework for the full reimbursement of the suit costs to a successful claimant by the company. Considered from a contractual theory perspective, a classical contract entails the representations of the parties and provides either implicitly or expressly the avenues for compensating a party that has been wronged by a party that has breached the contractual terms. It is the proposition of this study that on the vindication of the facts and prayers in a derivative claim, a successful claimant ought to be indemnified by the party that breached the contract and thus violated the interests of the minority shareholder.

This study recognizes that the proposition to have a successful applicant in a derivative suit fully reimbursed may be burdensome to a company. In instances where there may be multiple claims filed within a short period of time, the company may spend much time litigating as opposed to doing its core duty_ business. The time and resources spent in courts may derail the making of decisions that would have improved the prospects of a company. In addition to the losses incurred, a demand on a mandatory full reimbursement may be unfeasible. Consequently, the mechanisms for full reimbursement should, *inter alia*, entail a discretion of the court with factors such as the financial health of the company, the financial status of the applicant(s), the possible losses incurred by the company as a result of the suit and more so in instances that halted or reversed a decision through a derivative suit that has since been found unmerited, being considered.

In an effort to ensure that derivative suits achieve the intended purpose of protecting the interests of the minority shareholders, Kenya should consider adopting the model in the USA. This research

[116] Mocha TM., The Legal Protection of Minority Shareholders: A Comparative Analysis of the Regulatory Frameworks of Kenya and the United Kingdom *(Masters Dissertation, University of Nairobi), 2014*, 72.

recognizes that the USA is made up of more than 50 federal states, each with its own set of laws governing derivative actions. Consequently, as stated in the introduction to this chapter, this study proposes the USA model based on its Federal Rules of Civil Procedure and Model Business Corporation Act that form the basis of corporate law and governance in the USA.

In the USA, unlike the structure adopted in the UK and Kenya, there is no requirement to apply for leave to proceed with the substantive action. This situation removes the evidential burden placed on applicants in Kenya who are required to establish a *prima facie* case. This waives the trouble that an applicant in Kenya will have in trying to access information which will help in establishing a *prima facie* case since it is many times held by the board of directors who may not be willing to release it. In the end the court may fail to grant leave. In the place of application for leave, the USA has adopted certain requirements that guide the courts. A party that seeks to institute a derivative suit is required:

- to show a fair and adequate representation of the members of the company that are equally affected and seeking to enforce their rights against the company;[117]
- membership in the company at the time the act complained of happened;
- any steps taken internally to try and seek a solution.[118] The steps taken internally involve the writing of a demand to the directors requiring them to remedy a certain situation.[119]

It is the proposition of this study that the mode adopted in the USA is more flexible and Kenya should consider adopting the same. The requirement for a demand to the directors enables the company to effect remedial actions and thus avoid all derivative suits from making their way to the courtrooms. This situation helps in filtering the cases that end up in court. Adopting this model will also ensure that the applicant who finally ends up in court is armed with enough information, at very least, the companies to reply to his/her demand, and thus has a higher chance of succeeding.

It is important to note that the Companies Act of Kenya has given minority shareholders the power to challenge any conduct which they perceive to be oppressive, unfair or prejudicial to their interests in the company. This has been enhanced through granting them *locus standi* or the legal

[117] Section 7.41, *Model Business Corporations Act* (USA); Rule 23.1, *Federal Rules of Civil Procedure* (USA).
[118] Section 7.41, *Model Business Corporations* Act (USA); Rule 23.1, *Federal Rules of Civil Procedure* (USA).
[119] Rule 23.1, *Federal Rules of Civil Procedure* (USA).

standing to take on any such actions. For such a suit to be successful, the court must be satisfied that the following two elements have been fulfilled:[120]

- that the act already committed is unfair to its members or a portion of them; and
- that an action that is proposed would oppress the rights of the minorities.

However, the Model Corporations Act (USA) has established better mechanisms, for instance, through enshrining that the court upon the termination of the derivative action, may order the company to pay the plaintiff reasonable expenses that include the advocates fees that were incurred in the proceedings.[121]

In the upshot, the platform provided by derivative claims in Kenya leaves a lot to be desired. It has lots of pitfalls and promises an improved avenue for the protection of the interests of minority shareholders. The Law Commission of the UK in its consultation paper notes that, '…a member should be able to maintain proceedings about wrongs done to the company only in exceptional circumstances,' and 'shareholders should not be able to involve the company in litigation without good cause…'[122] The wide array of judicial discretion will inform the potency of derivative claims. In the premise, the gains to be attained are solely dependent on the interpretations that the judiciary will make, it is still too early to make an informed observation as to the direction that the same will take. However, it is undisputed that the rule in *Foss v Harbottle* should not be raised to a fetish so as to govern the courts from its graveyard and thus hinder the progressive laws in statute as regards derivative claims.

3.1.2 Duties of Directors and their Convergence with the Contractual Relationship Between the Company and the Minority Shareholders

The board of directors is the brain of the company. The direction that the corporate entity called the company takes is mainly dictated by the decisions taken by the board of directors composed of persons of corporate governance competency exercising discretionary powers.[123] Even though the minority shareholders sign the articles of association and thus become contractually bound to the company, the company is an artificial entity and therefore the implementation of the company's

[120] Section 780, *Companies Act* (Act No. 17 of 2015).
[121] Section 7.42, *Model Corporations Act* (USA).
[122] Law Commission, Shareholders' Remedies (1996) Consultation Paper No. 142, para 4.6.
[123] Paul LD. Sarah W and Christopher H., 'Principles of Modern Company Law.' 2021, 246.

vision is the board of directors. It is for this reason that the law has provided an avenue through the lifting of the corporate veil in order to establish the individuals, whether directors or director/shareholders or the majority shareholders, that occasion a wrong to the company. In instances of controlling shareholders also exercising the directorship roles, the risk of the interests to the minority shareholders is heightened. The majority shareholders are bound to be biased and serve their inherent interests under the veil of the company being a separate legal personality when in reality the two entities are indistinguishable. In essence therefore, the performance of directors' duties becomes a performance of the representation of the terms of the contract that the minority shareholders bind themselves to upon signing the articles of association. It is from this perspective that the study considers the duties of the directors, more especially director/shareholders as being contractually binding between the company as represented by the board of directors and the minority shareholders as the other party in the contractual relationship. In essence, these are situations where the company and the controlling shareholders are rendered indistinguishable as argued elsewhere in this study.

Prior to the enactment of the Companies Act, the director's duties were Common Law based. Currently, Part IX of the Companies Act of 2015 entails provisions that govern company directors. A private company must have at least one director whereas a public company must have at least two directors.[124] A company, whether private or public, must have at least one natural person as a director.[125] The law requires a company to keep a register of its directors.[126] It must be kept open for inspection at the registered office of the company or another authorized location.[127] The range of information that is required to be maintained by the company is vast. It ranges from personal information to professional engagements prior and presently. The information is key in forming the decision as to whether or not to hire the directors. For instance, the information on any other company directorship can be utilized to establish if there is a potential conflict of interest that may end up leading to a possible clash of duties. The requirement for directors to supply personal details, including their former name could be essential in knowing if such disciplinary measures as disqualification have been applied on a director under the former name.

[124] Section 128, *Companies Act* (Act No. 17 of 2015.
[125] Section 129 (1), *Companies Act* (Act No. 17 of 2015.
[126] Section 134 (1), *Companies Act* (Act No. 17 of 2015.
[127] Section 134 (3), *Companies Act* (Act No. 17 of 2015.

The Companies Act, 2015 includes detailed provisions regarding the duties of directors. This set of duties is well-crafted to address various intended objectives which include the protection of minority shareholders. The statute does not expressly state this, but it may be implied by a careful reading. The general duties of directors are premised on common law rules and equitable principles.[128] These are the rules that have been established to regulate the conduct and affairs of directors. The statute has basically codified them. A director must act within the scope of their authority. They should not exceed the scope of their authority as defined in the constitution of the company. They must also use the authority bestowed upon them for the purposes intended.[129] This prevents the directors from engaging in illegal activities. Furthermore, the minority shareholders who are affected by the majority shareholders' illegal and irregular acts and omissions, on which the directors have for one reason, or another refused to act, may invoke these provisions when challenging those illegal acts on behalf of the company. The duty to act within scope is meant to ensure that the directors only act in a manner that guarantees the success of the company and thus the contractual terms that the minority shareholders signed up to the articles of association are respected.

The law requires directors to promote the success of the company. A director should act in a way that they believe, in good faith, will promote the success of a company for the benefit of its members as a whole. In doing so, they should consider the following factors: long term consequences of their decisions; interests of the employees of their company; need to foster the company's business relationships with suppliers, customers and others; impact of the operations of the company on the community and the environment; desirability of the company to maintain a reputation for high standards of business conduct; and the need to act fairly as between the directors and the members of the company.[130] In some cases, minority shareholders may believe that the majority shareholders and directors are not working for the overall success of the company. In such cases, a person working on or deciding such a dispute may be guided by these factors. These are the indicators that are used to determine the extent of a director's failure to promote success of the company.

[128] Section 140 (3), *Companies Act* (Act No. 17 of 2015).
[129] Section 142, *Companies Act* (Act No. 17 of 2015).
[130] Section 143, *Companies Act* (Act No. 17 of 2015).

It is the proposition of this study that if in interpreting Section 144 on the duty of the director to promote the success of the company is to be weighed in light of the 'Business Judgment Rule' then the courts may be inclined to side with the boards of directors and thus scupper any derivative actions[131]. The Business Judgment Rule has the import of immunizing the company officers among them the board of directors from legal liability if it is established that the corporate transactions decisions they took were within their authority and that the same were made in good faith[132]. Viewed from this perspective, the pursuance of derivative actions will be diminished since not many applicants more so from within the boards of directors will pursue derivative actions on behalf of the company. The applicants will have to consider externalities such as the reputational damage to the company, the financial ramifications of the suits in order to justify their resort to the business judgment rule and thus avoid pursuing an avenue established for the protection of the interests of the minority shareholders. In the UK case of *Lesini & Others v Westrip Holdings Limited & Others*[133]*, Justice Lewison,* in determining whether there existed a mandatory bar to institute a derivative claim, proceeded to give an illustrative list of factors of directors acting in accordance with Section 172 of the UK Companies Act, 2006 that is the equal of Section 144 of the Kenyan Companies Act, 2015. Among the factors listed; '…the size of the claim, cost of the proceedings, disruption to the company's activities and the company's ability to fund the proceedings.'

Even though the *Lesini* case serves as persuasive authority, in the absence of Kenyan jurisprudence on the application of the Business Judgment Rule with regards to the interpretation of Section 144 of the Companies Act, 2015, many applicants may end up not filing the derivative suits in defence of the wronged company based on these illustrative factors. Further, the fact that 'good faith' is not defined in the Companies Act, lends the court a wide latitude in exercising their discretion to gauge whether a decision complained of in a derivative suit was taken in 'good faith'. The lack of clarity on what may or not amount to 'good faith' may lead to uncertainties at the leave stage application in Kenya.[134]

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[131] Lowry J and Reiberg A, *Pettet's Company Law: Company and Capital Markets Law*, 3ed, Pearson Longman, Harlow, 2009, 239.
[132] Lowry J and Reiberg A*, Pettet's Company Law*, 239.
[133] [2009] EWHC 2526, (Ch).
[134] Poole J and Roberts P, 'Shareholder remedies: Corporate wrongs and the derivative *action' Journal of Business Law* (1999) 107.

The law requires directors to exercise reasonable care, skill and diligence in carrying out their duties. This duty is measured to the standard that would be exercisable by a reasonably diligent person with the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions performed by the director in relation to the company; and the general knowledge, skill and experience that the director has.[135] The former is commonly referred to as a subjective test, whereas the latter is referred to as an objective test. This duty is not clear. This is attributable to the fact that it requires an analysis of what is 'reasonable.' The definition of what is 'reasonable' is not standard, as different interpretations may emerge depending on the specific circumstances. The courts are in charge of interpreting the law. For the sake of consistency, they should establish parameters that guide the interpretation of this duty. This duty is vital as it allows minority shareholders to hold directors accountable when they fail to exercise this duty and are shielded by the majority shareholders. This study contends that clarity in this duty can be utilized to establish whether in instances where the directors work in consonance with the majority and 'right' the 'wrongs' at the general meetings where they hold higher quotas can be classified as having been done with reasonable care, skill and diligence, and if not then liability to accrue to them.

Another important duty is to avoid conflict of interest. A director must avoid situations in which they have a direct or indirect interest that conflicts with the interests of the company. This most commonly applies to the exploitation of: any property; confidential information of the company; the director's position in the company; or opportunities in or for the company: provided that it is immaterial whether the company could benefit from the property, confidential information or opportunity. The Companies (Amendment) Act, 2017 introduced these provisions.[136] They came into effect on August 16, 2017, following the assent of this statute on July 21, 2017.[137] This provision is critical because it prevents directors from using their position to further selfish interests that conflict with the interests of the company. This amendment is particularly important where the directors hold shares in the company. Minority shareholders may rely on these provisions to even bring a derivative action on behalf of the company if the interests of the

[135] Section 145, *Companies Act* (Act No. 17 of 2015).
[136] Section 12, Companies (Amendment) Act, 2017.
[137] Preamble, *Companies (Amendment) Act*, 2017.

company are undermined and/or if the board of directors working in collision with the majority shareholders to the detriment of the interests of the minority shareholders.

The aforementioned duties of directors, among others, have entrenched safeguards aimed at promoting the interests of minority shareholders. Minority shareholders may use these provisions to hold directors accountable if they believe the latter are not working for the overall success of the company. The study has attempted to analyse some of the loopholes within the interpretation of some of the duties of directors that may be pursued to protect the interests of minority shareholders while at the same time exploited to defeat derivative suits that are one of the most important avenues for the protection of the interests of the minority shareholders. In the upshot, in this analysis there are avenues that have been touted as possible avenues that minority shareholders can pursue to protect their interests.

3.1.3 Enhanced Transparency and Disclosure in Companies

In 2019 there was an amendment to the Companies Act No. 17 of 2015.[138] The amendment of the Act makes it a mandatory requirement for companies to maintain two registers i.e. a register of members of the company and a register of the beneficial owners of the company.[139] The relevant information that the register of beneficial owners should contain are as prescribed in the Companies (Beneficial Ownership Information) Regulations 2019.[140] The information required to be entered into the register includes: the full name, national identity card number or passport, personal identification number, nationality, date of birth, postal address, residential address, current telephone number, current email address, occupation, date of becoming a beneficial owner, date of cessation as a beneficial owner, nature of ownership or control and any other information that the Registrar of Companies may require from time to time. The amendment is a departure from the former regime that never made it obligatory to provide information on the beneficial owners of a company.[141] The lacuna was a manifestation of the principle of separate legal personality that sought to shield the ultimate owners of the corporation and thus making it

[138] Statute Law *(Miscellaneous Amendments*) Act No. 12 of 2019. The Act came into effect on 23rd July 2019 approximately five months after the consummation of the takeover.
[139] Section 93A, *Companies Act* (Act No. 17 of 2015).
[140] Legal Notice No. 158 of 2019.
[141] The sections read as follows, *"…which shall include information relating to beneficial owners, if any…" "…including information relating to beneficial owners, if any…"* contained in section 93(8).

impossible or difficult for the minority shareholders to access information on the identity of the transacting parties in a transaction that infringes on their interests.

The Act defines a "'beneficial owner' as the natural person who ultimately owns or controls a legal person or arrangements or the natural person on whose behalf a transaction is conducted, and includes those persons who exercise ultimate effective control over a legal person or arrangement."[142] The definition of the term, 'control' has been defined by the regulations as one who holds at least 10% of the issued shares in the company; exercises at least 10% of the voting rights; holds a right to appoint or remove a director of the company; exercises significant influence or control over the company whether directly or indirectly.[143] On the other hand, the Income Tax Act defines control as those, 'holding of shares or voting power of 25% or more'.[144] Even though the primary legislation for companies is the Companies Act, the contradictions in definitions between the two statutes may be a gray area that can be utilized to avoid enforcement. Further, being that the Income Tax Act definition is contained in the Act itself and the Companies Act definition is enshrined in the regulations, hierarchically, the Income Tax Act definition may override the latter. Further, the requirement for 10% in the regulations does not clearly state whether the stake is cumulative in cases where the majority shareholder holds shares through institutional proxy corporate bodies each of which may own up to 9.9% so as to evade the legal requirement.

Even though it may be argued that the amendment may work to the protection of the minority shareholders, it is the position held by this study that there still exists a lacuna. The provision of Regulation 5 of the Regulations creates barriers to the access of the information. The three conditions highlighted above on which the information on beneficial ownership may be disclosed all pose a challenge in terms of access by the minority shareholders. Whereas this study appreciates the momentum in the contemporary world towards data privacy and data protection, the study makes a case for the balancing of this individual right with the interests of a vast majority in a company set up that hold a minority stake. The study argues that whenever the commercial interests of a vast majority of investors that belong to the minority shareholders limb are at stake, it will be a matter of public interest for the information of beneficial owners to be released to them

[142] Section 3 *Companies Act* (Companies Act No. 17 of 2015).
[143] Regulation 3(1)(m), *Companies (Beneficial Ownership Information) Regulations*, 2019.
[144] Section 2 *Income Tax Act* (Chapter 470 Laws of Kenya).

upfront. The upfront disclosure will equip the minority shareholders with necessary information, *inter alia*, the identity of the majority shareholders that they are dealing with. For instance, requiring that the information be only released with the written consent of the beneficial owner is self-defeating since it is highly unlikely that they will allow information that may work against them and their business interest to be released to their adversary. Secondly, requiring that the information be released in compliance with a court order, is equally retrogressive since for the minority shareholders to access the court system and extract an order to the effect, it may take time and sometimes the orders ultimately issued may be rendered nugatory and/or in vain.[145]

On the flipside, the requirement for the disclosure of beneficial ownership information may bring about ramifications to the business world. This is so in light of the provisions of Section 104 that requires the companies not to record any trust arrangements in the members' register.[146] Trusts are founded on confidentiality and this section remains unamended. The separate legal personality principle has always served to conceal information of investors by according them confidentiality and privacy. In the long run these regulations may affect the country's attractiveness to business investors from the international market.[147] Further, institutional shareholders such as pension funds and private equities are complex structures and therefore pose a difficulty in establishing the individuals behind them and therefore the aim of maximum disclosure and transparency may be defeated. For instance, in the current case study all the four major shareholders that were the proxies of the majority shareholder, were institutional shareholders with their own corporate structure and thus presenting a complicated identity that may not provide the much-needed information for the protection of the interest of the minority shareholders.

The study recognizes the difficulty that may befall an attempt to have all the beneficial ownership information of such complex corporate structures. However, this is a limitation that the study proposes in the current state that the minority shareholders have to live with. This proposal is based on the reality that in instances like public companies whose membership may range into millions, the date may be bulky and render it impossible to advocate for absolute disclosure.

[145]Regulation 5, *The Companies* (Beneficial Ownership Information) Regulations, 2019.
[146] Section 104 Companies Act (Companies Act No. 17 of 2015).
[147] Amendments to the Companies Act No. 17 of 2015: Registration of Beneficial Owners and Takeover Transactions in Kenya « Oraro & Company Advocates accessed 22 October 2021.

3.1.4 Rights of Members

A classical contract is based on rights and duties for the various parties that are in the contractual relationship. In recognition of this, the study utilizes contractarian theory to analyse how the rights of members as enshrined in the Companies Act have been utilized to protect the interests of the minority shareholders. The Companies Act of 2015 establishes the rights of members. These include: the right to be sent a proposed written resolution; the right to require circulation of a written resolution; the right to require directors to call a general meeting especially when they have failed to do so; the right to receive notices of general meetings with all the required information;[148] the right to require circulation of a statement; the right to appoint a proxy to act at a meeting; and the right to be sent a copy of the company's annual financial statement and reports.[149] The Companies Act, 2015 establishes information rights as well. It allows a member of a company whose shares are admitted to trading on a regulated market and who holds shares on behalf of another person to nominate a person to enjoy information rights.[150] These information rights include: the right to receive a copy of all communications sent by the company to its members in general or to any class of its members that includes the person making the nomination; the right to receive copies of the company's annual financial statements and reports; and the right to receive a hard copy version of a document or information provided in another form.[151]

The rights enumerated above are very important because they allow minority shareholders to seek information about the operation of the company, particularly when there is a suspicion of fraud or a violation of the constitution of the company by the majority shareholders. However, the rights enumerated in the Companies Act attach to all members of the company including the majority and minority shareholders. There is therefore bound to be a clash in exercising the rights with the majoritarian democratic rule being forever in favor of the majority shareholders and to the detriment of the minority shareholders. Further, it points to the inadequacies of the contractarian theory of governance since the contractual obligations are extinguished in the face of tyranny [majority shareholders]. The agents are legally bound to ensure that the exercise of one person's rights does not infringe on the exercise of the same right by the other. This scenario of competing interests and the information asymmetry between the majority and the minority shareholders

[148] Regulation 39, *Companies Act (General Regulations)* 2017 [Third Schedule].
[149] Section 114 (3), *Companies Act*, (Act No. 17 of 2015).
[150] Section 115, *Companies Act* (Act No. 17 of 2015).
[151] Section 115, *Companies Act* (Act No. 17 of 2015).

makes it impossible for the minority shareholders to invoke their rights under the Companies Act and adequately protect their interests.

The litany of rights enumerated above that are enjoyed by all members equally are essential for proper corporate governance. Information is power. By entrenching within the Companies Act the right of all members including the minority shareholders to receive among others the company's annual financial statements and reports, a diligent minority shareholder can microscopically comb within so as to ensure that the reports reflect the true picture of the company as a going concern. Further, it can help in establishing if the company is being managed as per the established resolutions and thus intervene where necessary so as to right where the company has been wronged or is in the vicinity of being wronged. To further aid the realization of this right, the Act requires that the minutes of all directors' meetings be recorded and kept for at least seven years. The record can be utilized by the minority shareholders to establish if the agents have acted in the interest of the principal.[152] The minutes can be utilized as evidence in a court of law as evidence of the proceedings unless the contrary is proven. The minutes will serve as transactional history of the deliberations that led to the taking of a particular decision and the reasons adduced for the adoption of the decision.

Specifically, the right to prevail on the directors to convene a meeting can be utilized to ensure that the minority shareholders' issues are discussed.[153] The required percentage of members that can petition for a general meeting is five percent in the case of a private company. The percentage threshold required in order to petition for a meeting is low enough to ensure that a sizable minority shareholder quota can requisition a meeting and even circulate a written resolution. However, upon the convening of a meeting the matters to be discussed are laid before the entire plenary of membership. Unless the meeting requested and convened are only limited to a particular class of shares, the entire membership of the company that requires specified quotas i.e., a simple majority for ordinary resolution and seventy-five percentage for a special resolution to make decisions at a general meeting duly convened. Towards this end, this provision may not be practical when it comes to influencing decisions within the company.

[152] Section 210, *Companies Act* (Act No. 17 of 2015).
[153] Section 277, *Companies Act* (Act No. 17 of 2015).

In the end, *Lucian Arye*[154] makes a case for the empowerment of shareholders when it comes to them having a say in the management of the company. *Lucian Arye* calls for the reconsideration of the concept of power separation between the shareholders and the management of the company. *Lucian's* proposition is informed by the traditional approach of corporate governance that excludes shareholders from making major decisions that affect the institution that they have invested in. He argues that the separation is not in the best interest of the shareholders and calls for the disruption of the management's monopoly in the making of major corporate governance decisions and instead advocates for the involvement of the shareholders in the initiation and passing of those decisions.

3.1.5 Protection of Members against Oppressive Conduct and Unfair Prejudice

Part XXIX of the Companies Act, 2015 provides for some avenues that the minority shareholders can utilize to protect their interests in conjunction with the other remedies littered elsewhere in the Act. These provisions enable a member of a company to apply to the High Court for an order of protection from oppressive conduct and unfair prejudice. This window is open when the affairs of a company are or have been conducted in an oppressive or unfairly prejudicial manner to the interests of members generally or of some part of its members including the applicant.[155] The protection provided by this section extends to nominees of a company's shares to whom shares have been transferred or have been transmitted by operation of law.[156]

In making an order to protect members from oppressive conduct and unfair prejudice, the High Court may: regulate the future conduct of the affairs of the company; authorize civil proceedings to be brought in the name and on behalf of the company by such person or persons and on such terms as the Court directs; require the company not to make any, or any specified, alterations in its articles without the leave of the Court; and direct the company to refrain from doing or continuing an oppressive act complained of; or to do an act that the applicant has complained it has omitted to do.[157] In these proceedings, the company is given the opportunity to present their side of the story. The law obligates the applicant member to serve it with a copy of the application. It is also required to appear as one of the respondents at the hearing of the application.[158] The law requires

[154] Lucian B, 'The Case for Increasing Shareholder Power' *Harvard Law Review*, 2005, 833.
[155] Section 780, *Companies Act* (Act No. 17 of 2015.
[156] Section 780, *Companies Act* (Act No. 17 of 2015).
[157] Section 782, *Companies Act* (Act No. 17 of 2015).
[158] Section 782, *Companies Act* (Act No. 17 of 2015).

that a copy of any order affecting the constitution of a company be lodged with the Registrar of Companies. This occurs when the High Court issues an order altering the Constitution of the company.

In the enactment of Section 780, the legislature lowered the threshold for oppressive conduct by the introduction of the term, 'unfair prejudice'.[159] The inclusion of the term 'unfair prejudice' covers a vast ground that enlarges protection for minority shareholders. In the United Kingdom, Section 210 was amended to address a difficulty in establishing a winding up case under just and equitable grounds. The amendment to the Act was informed by the Jenkins Committee[160] that recommended the introduction of the term 'unfairly prejudicial conduct' instead of 'oppressive conduct'[161] By allowing the court to lift the iron curtain and peak into the boardroom in order to injunct an oppressive and prejudice being meted on the minority shareholders, is a step in the right direction. It is a welcome move aimed at reducing instances of flawed and unethical outcomes that may accrue from the fictitious separation of the company from the majority shareholders that will exploit the buffer between them and the company.

3.1.6 Requirement of Unanimous Consent for the Addition of New Members

The Companies Act, 2015, provides that a company is a private company if its articles restrict a member's right to transfer shares; limit the number of members to fifty; and prohibit invitations to the public to subscribe for shares or debentures of the company; it is not a company limited by guarantee; and its certificate of incorporation states that it is a private company.[162] The Statute Law (Miscellaneous Amendments) Act of 2019 amends Section 9(1) (a) of the Companies Act of 2015. The articles of association of the private company must now include a requirement for the consent of all members to add a new member.[163] This amendment does not apply to public companies. Minority shareholders are protected by this amendment. Herein a transfer of existing shares or the issuance of new shares to a new member requires the approval of all shareholders. This means that the majority shareholders do not benefit from their numbers. This is perhaps the most protective provision of the minority shareholders. The provision avails a say to the minority

[159] Mwaura K, Statutory Protection for Oppressed Minority Shareholders in Kenya: Reflections on the Reforms under the Companies Act 2015, 211.
[160] The Report of the Company Law Committee, Chaired by Lord Jenkins (1962) Cmnd 1749.
[161] Section 994-999, *Companies Act* (UK).
[162] Section 9, *Companies Act* (Act No. 17 of 2015).
[163] Section 2, *Statute Law (Miscellaneous Amendments) Act*, 2019.

shareholders in the decision-making processes of the company. Requiring the approval of all shareholders means that for any additional shareholder there must be released all information concerning that shareholder and the effect on shareholding that it will have.

Further, the requirement for unanimity may equally impede a positive addition that could improve the shareholding and capital base for the company. The requirement for unanimity in order to admit a new member into a private company may create holdout problems within the company. Even though the minority shareholders may perceive it as an avenue to ensure that their voice is heard, there could arise situations where one or two shareholders whose stake when combined dwarfs the rest may erect a holdout blockade. With the holdout position it is possible for such shareholders to forestall any meaningful addition to the company that they perceive as diluting their stake.

3.1.7 Protect Minority Shareholders from Hostile Takeover

The Companies Act, 2015 provides for the right of the offeror to buy out minority shareholder(s).[164] These provisions are applicable as follows. The bidder has the option to buy the minority shares at the offer price. This right is activated upon satisfaction of a dual test. A bidder must have acquired or unconditionally contracted to acquire more than 90% of the shares subject to the offer as well as more than 90% of the voting rights in the company subject to the offer.[165] Minority shareholders have the right to be bought out. This right is upon satisfaction of a dual test. A minority shareholder has the right to require the bidder to buy the minority shareholder's shares at the offer price if the bidder had obtained 90 percent of both the issued shares and the voting rights in the company.[166] The Statute Law (Miscellaneous Amendments) Act, 2019 reduced the threshold from 90% to 50%.[167] This eroded the gains made in the Companies Act, 2015 in terms of minority shareholder protection. This provision allowed any bidder to easily force out any non-assenting shareholders if 50% of the shares to which the offer relates accepted the offer.[168]

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[164] Section 11, *Companies Act* (Act No. 17 of 2015).

[165] Kendall E, Vruti S, Richard H, *Kenya's Legislature Deals a Blow to Minority Shareholders,* available https://www.bowmanslaw.com/insights/mergers-and-acquisitions/kenyas-legislature-deals-a-blow-to-minority-shareholders/ (accessed May 21, 2021).

[166] Kendall E.,Vruti S., & Richard H., Kenya's Legislature Deals a Blow to Minority Shareholders, available https://www.bowmanslaw.com/insights/mergers-and-acquisitions/kenyas-legislature-deals-a-blow-to-minority-shareholders/ (accessed May 21, 2021).

[167] Section 2, *Statute Law (Miscellaneous Amendments) Act*, 2019.

[168] Kendall E.,Vruti S., & Richard H., Kenya's Legislature Deals a Blow to Minority Shareholders, available https://www.bowmanslaw.com/insights/mergers-and-acquisitions/kenyas-legislature-deals-a-blow-to-minority-shareholders/ (accessed May 21, 2021).

This resulted in several concerns from corporate stakeholders. The main area of concern was the vulnerable position in which the amendments in the Statute Law (Miscellaneous Amendments) Act, 2019 left the minority shareholders. These amendments, however, were short-lived. Concerned stakeholders, particularly the legislature, heeded the calls and reversed these amendments in the Business Laws (Amendment) Act, 2020. The Business Laws (Amendment) Act, 2020 is a huge relief for minority shareholders because it raises the threshold from 50% to 90%. The restoration of the percent to 90% ensures that there is increased protection of the minority shareholders.

The foregoing discussion has outlined some of the provisions in the Companies Act, 2015 that are aimed at protecting the interests of minority shareholders. The law must, of necessity, balance the protection of minority shareholders' rights with the safeguarding of the interests of the company overall. The study concedes that some of the claw backs that have been analyzed in this chapter could be perceived as necessary safeguards that any investor, including minority shareholders count on for a predictable and well-functioning legal environment for investment. Aware of these competing interests, this study proposes a number of recommendations in Chapter Five that will create a more efficient framework for the protection of the interests of minority shareholders while still allowing companies to thrive.

3.2 The Capital Markets Act, Cap 485A

This statute establishes the Capital Markets Authority[169] to promote, regulate and facilitate the development of an orderly, fair and efficient capital market in Kenya.[170] The CMA grants approval for listing for all public offers and listing of securities on any securities exchange in Kenya.[171] The Nairobi Securities Exchange (NSE), which operates under the jurisdiction of the CMA, conducts the listing. The principal objectives of CMA include imposing sanctions for violations of the regulations governing the listing and trading of any securities.[172] It is also tasked with issuing guidelines for takeover offers on listed asset backed securities.[173] The Minister is in charge of developing rules and regulations on listing and delisting of securities on a securities exchange; the

[169] Section 3, *Capital Markets Act*, Cap 485A.
[170] Preamble, *Capital Markets Act*, Cap 485A.
[171] Regulation 3(2), The Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, 2002.
[172] Section 3, *Capital Markets Act*, Cap 485A.
[173] Section 30Z (2) x, *Capital Markets Act*, Cap 485A.

disclosure requirements; and terms and conditions for listing or delisting from a securities exchange.[174] As a result, the following legal instruments have been established: the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, 2002[175] and the Capital Markets (Take-overs and Mergers) Regulations, 2002.[176]

The Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, 2002 provide guidelines for listing. Its first schedule entails the eligibility criteria for public offering of shares and listing. Besides, its second schedule entails eligibility criteria for public offering of debt securities and listing on the Fixed Income Securities Market Segment. The Capital Markets (Take-overs and Mergers) Regulations, 2002 govern the acquisition of shares of a listed company. Its Part II entails the takeover procedure. It provides that in order for foreign listed companies to acquire voting rights of a listed company, it must have at least 25% stake of their equity held by local shareholders.[177] These Regulations also entail provisions on the: obligations of offeror in relation to offer[178] and obligations of the offeree in relation to the offer.[179]

This statute also entails provision on insider trading. A person is deemed to commit the offence of insider trading if they encourage another person, knowingly or unknowingly, to deal in securities or their derivatives which are price-affected securities in relation to the insider information.[180] Insider information means information which relates to particular securities or to a particular issuer of securities; has not been made public; and if it were made public is likely to have a material effect on the price of the securities.[181] The Capital Markets Act lacks comprehensive provisions that protect interests of minority shareholders when majority shareholders devise a strategy to circumvent the regulations anchored and entailed therein. There is a possibility of companies circumventing the scrutiny of the regulator by delisting before a takeover and thus becoming a private entity.

[174] Section 12, *The Capital Markets Act*, Cap 485A.
[175] The Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, 2002, LN No. 60 of 2002, 3rd May 2002
[176] The Capital Markets (Take-overs and Mergers) Regulations, 2002, LN No. 160 of 2002, 10th July 2002.
[177] Regulation 3, *The Capital Markets (Take-overs and Mergers) Regulations*, 2002.
[178] Part III, *The Capital Markets (Take-overs and Mergers) Regulations*, 2002.
[179] Part IV, *The Capital Markets (Take-overs and Mergers) Regulations*, 2002.
[180] Section 32B, *Capital Markets Act*, Cap 485A.
[181] Section 32B, *Capital Markets Act*, Cap 485A.

The (Kenyan) Capital Markets Authority, which is mandated to implement provisions on securities regulation, has aided the minority shareholders by requiring the companies to disclose any material information which relate to their securities.[182] The majority shareholders are better placed to access such information primarily because they have power to control the entity and secondarily where they hold the controlling shareholder or director/shareholder status thus have a representation within the board of directors who have unlimited access to the corporate information.[183] The Capital Markets Act also lists the requirements to be fulfilled before a prospectus is made public. In addition to the statutory requirement of all public entities to report periodically to the public about the status of their accounts, the law helps the minority shareholders to keep an eye on the status of the company.[184] The overall objective of these statutory requirements is to protect those who have invested their capital from being exploited or manipulated by those who directly control and direct the business. [185] Implicitly, the High Court underscore that the requirements protect minority shareholders from the majoritarian dictatorship.

The CMA performs a critical role in establishing an enabling environment for investments. Its decisions are many times informed by established structures and procedures. However, its provisions can be bypassed through such business tricks as conversion of companies from public entities to private entities. As will be shown in Chapter Four, while discussing the case study, this is one such avenue pursued and thus denied the minority shareholders a platform to dispose of their shares in a free securities market economy.

3.3 Conclusion

Kenya has a legal framework that entails provisions to protect the interests of minority shareholders. The Companies Act, 2015 entails several provisions that minority shareholders can invoke to seek redress from the majority shareholders. The Capital Markets Act, Cap 485A, on the other hand, includes regulations and guidelines that govern transactions involving listed shares.

[182]Capital Markets Act Chapter 485A of the Laws of Kenya; Allen B. A, 'Statutory Protection for Oppressed Minority Shareholders: A Model for Reform' (1969) 55 *Virginia Law Review*.
[183] Mohamed Mitha and Others v Ibrahim Mitha and Others [1967] EA 575.
[184] Stephen J.C & Andrew TG, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. CAL. L. REV. 903 (1998).
[185] High Court at Nairobi (Nairobi Law Courts) Miscellaneous Civil Case 273 of 2012.

However, it is worth noting that this framework contains some gaps that are exploited by majority shareholders to achieve their intended objectives at the expense of minority shareholders. This study offers some recommendations that if implemented will improve the legal framework. In the long run through enhanced disclosure of companies' transactions minority investors have the powers to track the activities of the organization and to check the performance levels of the company directors. In addition to the transaction under Division 5 of the Act, the sustained developments in enhancing disclosure will ensure that shareholders have a bigger say in the corporate governance of the company.

In the discussion and analysis, this study has endeavored to underscore the fact that the shareholders are the true owners of the companies that they incorporate. Ordinarily, they entrust the management in the hands of the board of directors owing to their better understanding of corporate governance. In so doing, the shareholders have a legitimate expectation that the board of directors shall exercise their best of skill, judgment and knowledge to ensure success of the company. However, it is innate that human motives may be selfish. The director(s) may pursue some courses for the company with ulterior motives. It is on this background that the study adopts the propositions averred by Lucian Arye that seek to restate corporate governance and make shareholders a central figure in the management of the company.

CHAPTER FOUR: PROTECTION OF THE INTERESTS OF MINORITY SHAREHOLDERS: A CASE STUDY OF KENOLKOBIL LIMITED

4.0 Introduction

Chapter Three has laid down an extensive analysis of the various avenues enshrined in the legal provisions in the Companies Act, the Capital Markets Act and their subsidiary legislations and regulations. The analysis has also pointed out the gaps that exist within those provisions especially when perceived through the contractarian theory that this study has adopted. Chapter Four encompasses a case study of KenolKobil and the transactions leading to its takeover. The information is mainly drawn from secondary sources. The chapter is a build up to the facts that are provided in Chapter One of this study. The chapter builds up on the criticism that is posited to the fiction to the extent the insistence on the separation artificial legal personality of the corporate entity occasions an injustice to the minority shareholders.

4.1 Rationale for the Protection of the Interests of Minority Shareholders

This thesis proceeds on the premise that even though the relationship between the company and the minority shareholders is contractual in nature, there are justifications that warrant a departure from the classical contractarian relationship. *Ringe* makes a case for the non-interference in the sovereignty of shareholders to decide the internal affairs of the company.[186] In making this claim *Ringe* bases the argument on the freedom of contract account that advocates for the freedom to contract to be fully accorded to the shareholders and regulators not to intervene in the corporate decisions and affairs of the company. *Ringe's* arguments assume that the market is free and efficient. That the parties in the contractual relationship wield the same power and therefore can tailor contracts that reflects their different demands. *Coase* equally takes the position that parties

[186] Ringe WG, Deviations from Ownership-Control Proportionality-Economic Protectionism Revisited, in Company Law and Economic Protectionism: New Challenges to European Integration 212-13 (Ulf Bernitz and Wolf-Georg Ringe eds., 2010).

in a market economy should not have an intrusion of the law and regulators. This study analyses the propositions of the different theorists of the contractual and fiction theories. The study contextualizes the criticisms and shortcomings of each of the theories. The analysis of the shortcomings is through the argument that if the theories as propagated by the theorists are to remain unchallenged then the majority shareholders will utilize the time immemorial principles of fictitious separate legal personality, the corporate veil and limited liability to the detriment of minority shareholders.

Throughout the analysis and discussions, this study demonstrates that corporate law has a role to play in the relationship between the company and the minority shareholder. The analysis of the legal provisions and the criticism advanced paint the contractual relationship as inefficient to guarantee the protection of minority shareholders. If corporate law and regulators of the industry were to let the exigencies of the market and demand and supply dominate the corporate world, then there will be a downward trend in the protection of the interests of minority shareholders. This position was held by *Johnson* as a critique to the *Coasian* averments on the market being let to determine itself and the law having no use in contractual relationships as discussed in Chapter Two.

On the other hand, the fiction theory analysed in Chapter Two sought to distinguish the company from the natural persons who are the owners and who ultimately make the decisions that are associated with the corporate entity. This distinction has been criticized in this study as having a potential to create majority shareholders that do not exercise care, diligence and honesty in dealing with third parties and minority shareholders. The arguments of the proponents have been shown to portend a calamity to commercial undertakings by establishing shareholders that are shielded by the separate legal entity and its attendant virtues of limited liability and the belated lifting of the corporate veil.

This study illustrates some of the shortcomings of the contractarian relationship between the company and the minority shareholders and the unethical and flawed outcomes of the fiction theory using the KenolKobil Limited takeover case in the succeeding section. The study acknowledges that there have been attempts geared towards curing the detriments that minority shareholders face but as analyzed in Chapter Three the regulations and amendments that have been enacted still have loopholes that may be exploited.

4.2 The KenolKobil Takeover by Rubis

The following section undertakes a case study of KenolKobil Limited [now trading as Rubis] taking into account the events leading to its takeover. The study is conducted in the context of the exploitation of the principles of separate legal personality and corporate veil to defeat the contractual rights of the minority shareholders. The study indicates the effect of the two concepts as far as the protection or infringement of interests of minority shareholders is concerned. This thesis delves into the activities that transpired in the process of takeover of KenolKobil by Rubis.

In the takeover bid of KenolKobil, the majority shareholder was reported to have been the estate of the late Nicholas Biwott.[187] Investigations carried out by the *Business Daily* almost a decade ago had already revealed an opaque shareholding structure in KenolKobil.[188] In the investigation it was reported that the CMA claimed not to have powers to order for a disclosure of beneficial owners behind the shell companies and secret nominee account that owned a majority stake in KenolKobil Limited.[189]

The company was taken over by a French firm Rubis Energie SAS (Rubis), a subsidiary of the Rubis SCA which is an international firm that deals in the storage, distribution and sale of petroleum, liquefied petroleum gas, food and chemical products[190] through a deal that was formalized in March 2019.[191] The acquirer was reported to have set out on a two-prong plan that would have either seen them attain a 90% of shareholding and thus invoke a 'squeeze out' of the minority shareholders pursuant to the Companies Act;[192] but if it secured 75% the company' shareholding it intended to delist from the Nairobi Securities Exchange. Through the delisting, by law the company would have converted into a private entity and thus denying the minority shareholders in KenolKobil the latitude of disposing their shares in a free market economy.[193] The

[187] The late Nicholas Biwott acquired the assets of Mobil Oil through Kobil limited when it was exting the Kenyan market. At this point in time the late Nicholas Biwott was serving as Energy Minister in the late President Moi era. See also: Biwott's family to pocket billions in KenolKobil buyout - The Standard (standardmedia.co.ke) accessed 20 June 2021.

[188] Buyout deal to thicken mask on KenolKobil owners' faces - Business Daily (businessdailyafrica.com) accessed 6 November 2021.

[189] Buyout deal to thicken mask on KenolKobil owners' faces - Business Daily (businessdailyafrica.com) accessed 6 November 2021.

[190] CAK_Decision_on_Acquisition_of_KenolKobil_Plc_by_Rubis_Energie_SAS.pdf accessed 20 June 2021.

[191] Biwott's family to pocket billions in KenolKobil buyout - The Standard (standardmedia.co.ke) accessed 20 June 2021.

[192] Section 611 *Companies Act* (Act No 17 of 2015).

[193] https://www.reuters.com/article/us-kenolkobil-acquisition-idUSKCN1MY0GK accessed 20 June 2021.

Competition Authority of Kenya approved the takeover since in its view the structure and concentration of the market was unlikely to change since the acquirer, Rubis Energie did not have operations in Kenya. In the takeover, there are key findings that shaped the entire transaction as outlined below:

First, *Muchiri* notes that during the takeover of KenolKobil, an attempt was made by various news agencies to identify who most owners of the company were.[194] It was reported in the dailies that most of the identities were concealed and that a sizable number used proxy shareholders. The proxy shareholders could not reveal the people that they held the shares for on the basis that the Companies Act recognizes proxies as legitimate entities in company transactions.[195] Owing to the fictitious separate legal identity of the company it is possible for the majority shareholder to exercise their right to appoint proxies and pursue their intentions through them. In the end minority shareholders are limited in holding the majority shareholders accountable when the latter are shadowy and only using proxies. Were it not for the separate legal personality that bars the shareholders from active participation in the day-to-day management affairs of the company, it would be easy to keep abreast with the happenings and thus ensure proper disclosures and transparency in transactions. Further, it would be easy to establish the true identities of the persons behind the transaction and thus avail the minority shareholders necessary information to stop any foul play.

The company being a fictitious separate personality exists distinctively from the shareholders. In this instance the majority shareholders while presumably seeking to draw benefits from the company at the expense of the minority shareholders used the legally accorded virtues to companies i.e., proxies. The proxies legally ran the transaction. However, there is a possibility of unethical and flawed ends to the justice of the minority shareholders in such a transaction where the true identity of transacting parties is not disclosed upfront. Had the Companies (Beneficial Ownership Information) Regulations, 2019 been in place, it is the position of this study that would

[194] Muchiri JW, 'Internationalization: Foreign Market Entry and Operation Strategy by KenolKobil Limited' 49 (*Masters Dissertation University of Nairobi, 2018)*.

[195] Buyout deal to thicken mask on KenolKobil owners' faces - Business Daily (businessdailyafrica.com) accessed 6 November 2021. One such proxy was reportedly to be Desterio, a prominent lawyer that represented Nicholas Biwott in a number of cases in court and at the same time held shares in Petroholdings, Chery Holding and Highfield. At the same time the lawyer served as Non-Executive Director in KenolKobil Limited. In an interview with the Business Daily that conducted the referred investigation, allegedly Mr. Desterio declared that he held shares on behalf of his clients but was bound by duty of client confidentiality not to disclose their identity.

have to a limited extent disclosed the true identity of those involved in the transactions and thus enhanced transparency.

Secondly, during the KenolKobil takeover, the minority shareholders were excluded from the entire process right from the beginning.[196] The directors, while knowing pretty well that they are covered by the principle of the corporate veil from liability provided they act within their statutory duties, proceeded in a calculated move that excluded the minority shareholders. In as much as the moves by the majority shareholders and the directors of the company did not break any laws because of the corporate veil and the company being a separate personality from its owners (majority and minority shareholders as a joint unit), there is a need for more transparency and consultations with the minority shareholders in transactions of such nature to determine exactly where their interests lie. Such consultations might also result in collective brainstorming that brings about even more efficient ideas on how to deal with situations that arise in the day-to-day operations of companies.

Thirdly, the study of the takeover of KenolKobil Limited was reported to have been earmarked for delisting from the Nairobi Securities Exchange which eventually happened.[197] The implication that this had on the thousands of minority shareholders is that the company faced the prospect of conversion into a private company that could not be easily monitored by regulators such as the Capital Markets Authority. Minority shareholders in such situations are highly susceptible to be legally unprotected and uninvolved especially if unscrupulous or shadowy shareholders and directors are the ones making all the decisions.[198] This damning finding should be a cause of alarm for not just minority shareholders but also market regulators in any future transactions such as takeovers and mergers.[199]

[196] Muchiri JW, 'Internationalization: Foreign Market Entry and Operation Strategy by KenolKobil Limited' 49 (*Masters Dissertation University of Nairobi, 2018)*. See also<Buyout deal to thicken mask on KenolKobil owners' faces - Business Daily (businessdailyafrica.com) accessed 6 November 2021> and <Biwott's family to pocket billions in KenolKobil buyout - The Standard (standardmedia.co.ke) accessed 6 November 2021>.

[197]Muchiri JW, 'Internationalization: Foreign Market Entry and Operation Strategy by Kenol-Kobil Limited *(Masters Dissertation, University of Nairobi), 2018*, 49.) See also <Buyout deal to thicken mask on KenolKobil owners' faces - Business Daily (businessdailyafrica.com) accessed 6 November 2021> and <Biwott's family to pocket billions in KenolKobil buyout - The Standard (standardmedia.co.ke) accessed 6 November 2021>.

[198]Angir RA, 'Effect of Mergers and Acquisitions Announcements on the Stock Returns of the Companies Listed at the Nairobi Securities Exchange' 58.

[199] https://citizentv.co.ke/business/french-companys-takeover-of-kenolkobil-in-final-stages-226442/ accessed 20 June 2021.

The treatment of minority shareholders in the KenolKobil acquisition yet again reveals that companies do not exist solely for controlling shareholders and directors. There are so many stakeholders involved who have various interests. Apart from the minority shareholders, there exist the government, different regulators and foreign investors who might have interests in how the business environment operates in the country.[200] The presence of such a network is sufficient cause for broad consultations and the protection of everyone's interests hence the need for minority shareholders to be involved. It is such moves that promote investor confidence and ultimately contribute towards the collective development of the economy. Additionally, good corporate governance necessitates for minority shareholders to be treated with dignity and to be made aware of any decisions that would significantly impact their status.[201]

Last but not least, in a statement released by *Aly-Khan Satchu*, a stockbroking agent for Kestrel Capital (East Africa) Limited,[202] which is an investment advisory firm, regarding the KenolKobil acquisition he stated that 'in as much as the majority shareholders of the company had not disregarded the law by hiding behind the corporate veil, they should have been more open to the minority or non-controlling shareholders.'[203] The statement is an accurate reflection of what transpired. The majority shareholders exploited the two principles of separate legal entity and corporate veil to advance their interests at the expense of the minority shareholders. The enormity of the transaction had necessitated for total inclusion of the minority shareholders but that was not the case.

4.3 Convergence with the Concepts of Separate Legal Personality and Corporate Veil

The findings in the KenolKobil case study and the discussion of the two concepts of separate legal personality and corporate veil throughout this study demand an answer to the question: *what is the role of minority shareholders in the corporate governance as well as in the making of substantive decisions which affect companies in the modern business environment?*

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[200]Shubham PC and Murty LS, 'Secondary Stakeholder Pressures and Organizational Adoption of Sustainable Operations Practices: The Mediating Role of Primary Stakeholders' (2018) 27 *Business Strategy and the Environment* 910.

[201] Outa ER, Eisenberg P, Ozili PK, 'The Impact of Corporate Governance Code on Earnings Management in Listed Non-Financial Firms: Evidence From Kenya' *(Social Science Research Network 2017) SSRN Scholarly Paper ID 3189474* <https://papers.ssrn.com/abstract=3189474> accessed 13 June 2021.

[202] Annual Report & Financial Statements for the Year Ended 30 June 2019, 82.

[203] <Buyout deal to thicken mask on KenolKobil owners' faces - Business Daily (businessdailyafrica.com) accessed 6 November 2021>.

The history of company law in Kenya is replete with instances where controlling shareholders and the boards of directors acted contrary to the rights of minority shareholders.[204] Equally in the history of companies around the world, many corporations have collapsed because of poor corporate governance which results from too much power being concentrated in majority shareholders and directors. In such situations, the unfortunate realization is that the minority shareholders tend to be the biggest losers among the parties.[205] In as much as they do not take part in major discourses concerning companies, there is no doubt that they act as insurance against issues like management self-interest especially in sprouting markets that are characterized by weak capital bases.

Whenever conflicts or disagreements arise between majority shareholders and minority shareholders, it is almost always imminent for the controlling shareholders to carry the day.[206] Company directors who are in charge of the day to day operations also tend to advance the interests of the majority shareholders on most occasions.[207] It is against this background that the legislature made changes in statutory law starting with the Companies Act and the Capital Markets Act.[208] The Companies Act for instance is very categorical of the duties of directors as agents of all the shareholders.[209] Some of the director duties that have been emphasized include not just the general ones but also specific ones such as the duty to obtain the approval of all shareholders before entering into certain transactions that are critical to company operations. Other duties of the ilk which are geared towards protecting minority shareholders include the duty to steer their companies towards success while acting in the best interests of shareholders and the duty to use reasonable care and diligence at any time that they perform their functions.[210]

[204] Nyakeri BA, 'The Law on Corporate Governance and Shareholder Protection in Kenya: A Case for Reduction of Corporate Scandals within Private Companies' 117.

[205]Ricardo DB, Ribeiro PS and Sanvicente A, 'The Outcome Versus Substitute Models of Dividends: A Change in Minority Shareholder Protection' *(Social Science Research Network 2020) SSRN Scholarly Paper ID 3621120* <https://papers.ssrn.com/abstract=3621120> accessed 13 June 2021.

[206] Hamdani A And Hannes S, 'The Future of Shareholder Activism' 99 *Boston University Law Review* 30.

[207] Hamdani A And Hannes S, 'The Future of Shareholder Activism' 99 *Boston University Law Review* 30.

[208]Kiarie KD, 'Investigating Factors Which Influence the Practice of Corporate Governance within the Kenyan Corporate Sector' <http://oro.open.ac.uk/id/eprint/51777> accessed 13 June 2021.

[209]Kiima SM, 'Codification of Duties of Directors Under the Companies Act, 2015: An Analysis of Their Clarity, Accessibility and Certainty' *(Thesis, University of Nairobi 2020)* <http://erepository.uonbi.ac.ke/handle/11295/154228> accessed 13 June 2021.

[210] Kiarie KD, 'Investigating Factors Which Influence the Practice of Corporate Governance within the Kenyan Corporate Sector' <http://oro.open.ac.uk/id/eprint/51777> accessed 13 June 2021.

The role and importance of minority shareholders in modern corporate governance cannot be overstated. Studies have proved that a strict unrestricted application of the majority rule in companies often brings serious harm not just to the interests of minority shareholders but also to the companies as a whole and the economy.[211] This is because whenever minority shareholders are sidelined, investor confidence in companies reduces and that might have an overall negative effect on the economy given the important place that companies occupy in nations. Another reason why such unrestricted application of the majority rule is harmful is that it might create centers of power in the board of directors who would in turn act mainly in their interests and not as agents of shareholders who own the company.

In light of these observations, corporate governance requires the input of minority shareholders as it does the considerations of majority shareholders.[212] The Corporate Governance Code of Kenya states that the business and affairs of companies should be conducted in a manner that enhances prosperity in the country and leads to ultimate corporate accountability while at the same time realizing long-term values for shareholders.[213] This cannot be achieved by sidelining minority shareholders. Their interests and rights have to be protected at all times if such objectives are to be achieved. Additionally, they should be informed about major transactions that are likely to impact them such as takeovers and acquisitions. Apart from the ethical dimensions of doing such, it is possible that great ideas can come from these shareholders when they are adequately involved and informed in whatever major decisions are taking place at their companies.

In the upshot, it has emerged that in most instances, majority shareholders tend to exploit the concepts of separate legal personality and corporate veil to engage in acts that are detrimental to minority shareholders. In as much as the exception to the rule in *Foss v Harbottle*[214] and the provisions of the Companies Act provide for a derivative action, sometimes the majority shareholders are brilliant enough to engage in acts that are not fraudulent on the surface and use the corporate veil as their shield. This was the case with the KenolKobil Limited acquisition.

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[211]'The Voice of Minority Shareholders: Online Voting and Corporate Social Responsibility - *ScienceDirect*' <https://www.sciencedirect.com/science/article/abs/pii/S0275531921000295?dgcid=rss_sd_all> accessed 13 June 2021.

[212]'The Voice of Minority Shareholders: Online Voting and Corporate Social Responsibility - ScienceDirect' (n 34).

[213] Kiarie KD, '*Investigating Factors Which Influence the Practice of Corporate Governance within the Kenyan Corporate Sector*' <http://oro.open.ac.uk/id/eprint/51777> accessed 13 June 2021.

[214] Wedderburn KW, '*Shareholders' Rights and the Rule in Foss v. Harbottle' (1957)* 194.

4.4 Conclusion

In conclusion, it can be argued that a company through its fictitious separate legal identity assumes an independent and self-governing personality. In subscribing to the articles of association, the minority shareholders agree to be bound by the decisions of the majority shareholders. Whereas this position cannot be disputed to inherently exist in corporate governance, this study makes a case for an intrusion by government and regulators to protect the interests of the weaker party_ minority shareholders. The strict application of the 'Majority rule principle,' '… *by becoming a shareholder in a company, a person undertakes by his contract to be bound by the decisions of the prescribed majority shareholders, if those decisions on the affairs of the company are arrived at in accordance with the law, even when they adversely affect his own rights as a shareholder*,'[215] will create an oppressive business environment. As thus, there should be a legitimate expectation on the part of the minority shareholders that there will be ultimate transparency in the business transactions and that they are accorded avenues that they can successfully and efficiently utilize to challenge and reverse unfair, prejudicial and oppressive decisions by the majority.

[215] Trollip JA Samuel and Others v President Brand Gold Mining Company [1969] (3) SA 629 (A).

CHAPTER FIVE: CONCLUSION AND RECOMMENDATIONS

5.0 Introduction

This thesis set out on an ambitious task of assessing the efficacy of Kenyan laws such as the Companies Act, the Capital Markets Act and case law among others in the protection of minority shareholders. In order to conduct this study, the concepts such as separate legal personality and corporate veil were considered. The previous chapters have revealed interesting legal phenomena and information that ought now to lead to the conclusions that will be drawn below. This chapter is categorized into the summary of the study, conclusion and recommendations.

5.1 Summary of the Study

Companies are increasingly being used as the most suitable vehicles for investment. Their suitability is partly due to their characteristics of having a separate legal personality, having a limited liability, in their corporate personality can sue and be sued, take loans and hold property in its own person. In the corporate governance structure upon the formation of a company, the shareholders appoint a board of directors that run the day-to-day activities of the company. In this structure of governance, the shareholders play no role in the management of the company save for the decision such as change of the memorandum of associations, electing and voting out the board of directors.

The legal framework that exists in Kenya for the management of companies is enshrined in several acts among them the Companies Act, the Capital Markets Act and the caselaw. Of importance to this study was the legal protections afforded to the protection of minority shareholders. In the analysis that unfolded, it was evident that much has been done to protect the minorities but much more still needs to be done.

5.2 Conclusion

In the upshot the inevitable conclusion that commends itself is that the minority shareholders have a role in corporate governance. It is necessary to protect them for reasons that go beyond the

company itself. Apart from the benefits of inclusion and cooperation, there is an ethical sense of duty as stipulated in the Corporate Governance Code which should guarantee that they are included in governance and have their rights protected.

From the discussions in this study, there are interesting findings that would go a long way in shaping the future legal regime for the protection of the rights of minority shareholders. First of all, there is an acknowledgement of the fact that the relationship between shareholders (both majority and minority) and directors is muddled with some complicated and formalistic structures of corporate governance. Early economists such as Adam Smith noted with foresight that there are real possibilities of workers not serving with the interests of the owners of businesses in mind in any corporate-commercial relationship.[216]

This is a challenge that most proprietors have to contend with in the modern global business environment. As has been noted in a number of legal commentaries, directors entrusted to manage the corporate body due to their entrepreneurial skills and corporate competence may sometimes serve personal ends and interests.[217] In the company context, the directors who act as agents of shareholders tend to sideline the minority shareholders and only pursue actions that are of interest to either them or to the controlling shareholders.

5.3 Recommendations

Drawing from the discussions above and in the previous chapters it is paramount that recommendations be put forth that are geared towards enhancing the available mechanisms to safeguard the interests of minority shareholders. This study underscores the fact that corporate law is in a state of flux. The prevailing circumstances that triggered a certain change in law yesteryears may not be the same today. Corporate law is dynamic and the legislatures and legal practitioners need to keep abreast with the forces which warrant amendments and enactment of new laws. In this regard, the following recommendations are suggested to address some of the lacunae that exist in law as per the analysis in this study:

[216]Piqué P, 'The Theory of Moral Sentiments and The Wealth of Nations. Ethics, Jurisprudence and Political Economy throughout the Intellectual History of Adam Smith' (2019) 12 *The Journal of Philosophical Economics* 75.

[217]Lin H, '*Essay on Contract Structure in Principal-Agent Problems with Behavioral Models'* <https://drum.lib.umd.edu/handle/1903/22085> accessed 13 June 2021.

1. The study recommends the repeal of the requirement for leave stage in the lodging of a derivative suit. The repeal of the leave stage will remove unnecessary barriers to timely and sufficient access to justice, [that is a constitutional decree], for minority shareholders. This proposition will be in tandem with recent jurisprudence from the Constitutional Court that found declared the leave stage in judicial review cases as not serving a practical role.[218]
2. In the alternative to recommendation (1) above, since the repeal of leave stage may seem radical at the moment owing to the fact that the Companies Act is relatively recent, the study proposes the establishment of procedures and timelines that guide derivative claim applications. Derivative actions are very important because they not only enable the non-controlling shareholders to institute actions but also to enforce both their rights and those of their companies. The procedure for the leave and substantive stages in filing applications for derivative claims should be included in the Civil Procedure Rules. This objective could be realized by amending the current Civil Procedure Rules, 2010, or by incorporating this aspect into the new Civil Procedure Rules if the Rules Committee established under Section 81 of the Civil Procedure Act[219] decides to revoke the current rules and replace them with the new ones. The United Kingdom's legal framework could be a vital guide in the establishment of the rules.[220]
3. The study proposes the establishment of a compensation framework for a successful claimant. The current framework entails no compensation framework and thus may scare potential claimants from lodging derivative claims. The Kenyan framework can adopt the USA mechanism as discussed in Chapter Three, that established a framework for the company to cater for the costs of litigation and at the same time impose penalties on a frivolous minority shareholder. This will encourage more claimants to lodge claims that will enhance the corporate governance structures for the protection of the interests of minority shareholders. The establishment of the fund will also go a long way in facilitating

[218] Felix Kiprono Matagei v Attorney General and the Law Society of Kenya, Petition No. 337 of 2018;
This was a case filed by the Applicant [a lawyer] on his behalf and on behalf of the general public in the Constitutional and Human Rights Division seeking a declaration that Section 8 and 9 of the Law Reform Act, Order 53, Rule 1 of the Civil procedure Rules, 2010 are unconstitutional, null and void. In decreeing and granting the prayers, Justice Weldon Korir, inter alia, referred to Section 7(1) of the Sixth Schedule to the Constitution of Kenya, 2010, '… all law in force immediately before the effective date continues in force and shall be construed with alterations, adaptations, qualifications and exceptions necessary to bring it into conformity with this constitution."
[219] Cap 21, Laws of Kenya.
[220] See Part 19, Practice Direction 19C on Derivative Claims, Civil procedure Rules (Rules and Directions) (UK).

the realization, promotion and safeguarding access to justice that is a fundamental human right and pillar of the judicial system in Kenya. The application of the indemnification fund should also allow a judge discretion upon the verification of the merits and demerits of the case so as not to encourage frivolous suits.[221]

4. The study recommends the establishment of a dispute resolution mechanism in the Companies Act with proper structures provided for under the subsidiary legislations. The alternative dispute resolution mechanism should assume the form adopted in the USA as discussed in Chapter Three. There should be internal mechanisms that minority shareholders can utilize before proceeding to lodge a derivative suit. For instance, the creation of 'a demand stage' through raising a letter of complaint to the relevant authorities within the company's hierarchy. This will avail the minority shareholders an avenue to gather information through the replies or lack thereof to their complaints which information can be used to build up a prima facie case at the leave stage of a derivative action. This will help in resolving many of the concerns internally at the first instance through an amicable resolution between the parties or alternatively through such avenues as arbitration, preserving the resources of the company, retaining a harmonious business environment among the shareholders as a cumulative unity and also filtering those cases that must ultimately end up as derivative claims in court.
5. The study proposes that there be a harmonization of Section 3(1)(m) of Companies (Beneficial Ownership Information) Regulations 2019 with Section 2 of the Income Tax Act. In harmonizing the two provisions on what 'control' means as far as exercising significant control and influence in a company means, there should be a further clarity on whether the control can be through a cumulative ownership.
6. The study proposes that there should be a shareholder-centred approach to corporate governance. The shareholders cumulatively should be the primary focus. This recommendation can be achieved through the restructuring of the duties of directors to ensure that there is more consultation with the shareholders and ensuring there is a representation of the minority shareholders in the boardroom when certain subjects such as takeovers are being considered. The representation in the boardroom could be on *ad hoc*

[221] Tonstate Group v Wojakovski [2019] EWHC 857 (Ch). See also Rule 19.9, Civil Procedure Rules (UK).

basis. The restructuring of these duties will in the end create a suitable legal framework that will foster corporate success.

7. The study recommends the creation of additional regulations to supplement the existing rules that regulate the conduct of director/shareholders and majority shareholders. These regulations should also provide for the disclosure of the identities behind the proxies that bid in takeovers and business restructuring. This recommendation will cover scenarios of director/shareholders that are prone to instances of conflicts of interest and that end up abusing the information asymmetry to their advantage. (Assuming that the directors are also the majority shareholders or colluded with the majority) The situations of exploitation through proxies are not hard to come by. It is common for directors to use their positions to exploit company property, use confidential information in a prejudicial manner and secretly engage in illegal transactions with the company. The existence of such regulations can be of great help to minority shareholders in bringing derivative actions on behalf of the company when the interests of the company are undermined. Further, there should be established proper criteria on the use of the business judgment rule so as to reduce instances that may be invoked to defeat the lodging of derivative suits.
8. The study recommends the introduction of stiffer penalties for the breach of director duties more so in instances where they intentionally work in unison with the majority shareholders to oppress them. These penalties will be in addition to the disqualification orders enshrined in the Companies Act. Disqualification of directors in cases of prejudicial conflicts of interest may be one such penalty.
9. The study recommends that there should be a quasi-contractarian relationship between the boards and companies. This will ensure that the boards act solely in the interest of the companies in its general view of both the majority and the minority. This will ensure that decisions which are precarious to the minorities through allowing the exigencies of the market to determine the decisions that are taken by the boards of directors and supported by the majority shareholders. In so doing, the directors will bind themselves to a set of contractual obligations that are acceptable to all shareholders as a collective unit, that if breached, the director's position is vacated by contractual fiat.
10. The study proposes increased shareholder rights and role in the major corporate governance decisions and a better clarity of the ownership and control structures within companies.

The traditional approach that bestows the corporate governance of the companies solely in the hands of the board of directors should be reconsidered. Shareholder engagement more so in decisions like takeovers should have their shareholder approval beyond the special resolution requirements but definitely not unanimity. Unanimity may occasion commercial quagmire and thus hamper the economic growth of a country and arrest the development of individuals that chose to use companies as corporate vehicles for investment. Consequently, the study proposes that where the minority shareholders have been accorded reasonable information on the prospects of the proposed transaction that is supported by not less than 90% of the shareholders and are still unwilling to be party to the same, the company be allowed to issue a premium value for the shares.

Based on the research and analysis of this study, and further compounded by the development of corporate law over time, this study recommends further research on the relevance of the rule in the Salomon case.

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Appendices

The Ethical Clearance Certificate

Final Decision

This document certifies that the study:

\\\"LEGAL PROTECTIONS ACCORDED TO MINORITY SHAREHOLDERS IN KENYA IN CORPORATE ENTITIES \\\"

Principal Investigator: ALFAYO, ONGERI
Reference number: SU-IERC1194/21

Was reviewed and received the following status:
\\\"**done**\\\"
Additional Comments: Final decision: **approved**
Comments sent:

Reviewer #1:
'recommended for approval'

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